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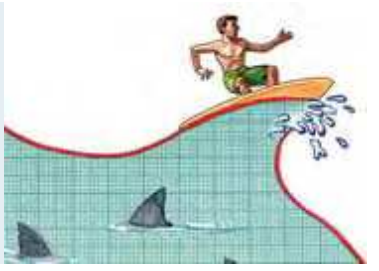
Modern finance is undergoing its harshest test. It will not be pretty but it is necessary: leader



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Politics this week

Aug 16th 2007
From The Economist print edition

AP

In **Iraq** at least 250 people were killed and hundreds more injured in a co-ordinated four-bomb attack on the Yazidi community in the north-west of the country. It was the single deadliest insurgent strike in more than four years of war. The American army blamed al-Qaeda for the bombings. Meanwhile the prime minister, Nuri al-Maliki, held a series of meetings with the main Sunni, Shia and Kurdish party blocks in an effort to break the political deadlock in the country. See article

Binyamin Netanyahu, **Israel's** former prime minister, comfortably retained the leadership of his centre-right Likud party in a primary election. Moshe Feiglin, a once-marginal figure from the extreme right, garnered 23%, stoking fears in the Likud mainstream about the party's future.

America confirmed that it was considering designating Iran's **Revolutionary Guards** as a terrorist organisation. The force is a political and commercial as well as military power in Iran. The move might make it vulnerable to international sanctions.

Sierra Leone went to the polls to elect a new president. Observers declared the election, the second since the end of the country's civil war in 2002, to be free and fair.

Trouble on the line

A home-made bomb exploded on a railway line in **Russia**, derailing the Moscow-St Petersburg express and injuring scores of passengers. Russia has had a recent lull in terrorist attacks. The police are looking for two suspects.

Turkey's ruling Justice and Development (AK) Party nominated Abdullah Gul, the foreign minister, to the presidency. It was the fiercely secular army's objections to the previous nomination of Mr Gul that led to the recent election, which AK won handsomely. See article

Poland is likely to have an early election after its government fell apart. The prime minister, Jaroslaw Kaczynski, sacked all four ministers from his two junior coalition partners. Mr Kaczynski's party, Law and Justice, is trailing its right-wing rival, Civic Platform, in the opinion polls. See article

Six **Italians** thought to be linked to a feud within the Calabrian 'Ndrangheta organised-crime group were shot dead in the centre of Duisburg, Germany. See article

Good times, and bad times

EPA

India celebrated 60 years of independence from Britain with Manmohan Singh, the prime minister, promising that “the best is yet to come”. Meanwhile, **Pakistan** marked the 60th anniversary since its bloody partition from India, unsure how its president, General Pervez Musharraf, would overcome his declining fortunes. America has dissuaded him, for now, from declaring a state of emergency. See article

Severe flooding is thought to have left 300,000 **North Koreans** without homes and ruined a tenth of all farmland in what is already an economic basket case. International agencies are eager to help, but find it hard to operate in the world's most repressive state. A decade ago, famine killed up to 2m people, and many in North Korea are malnourished today. See article

A court in **Taiwan** cleared Ma Ying-jeou, the opposition Kuomintang's candidate for presidential elections next March, of charges of corruption while he was mayor of Taipei, boosting his chances of succeeding Chen Shui-bian. The ruling party's contender, Frank Hsieh, faces similar allegations of corruption.

Myanmar's military junta doubled the price of petrol and diesel, sending cars and buses off the road. The Burmese are already suffering from economic mismanagement and from Western embargoes imposed in protest against the detention of the democratic opposition leader, Aung San Suu Kyi.

Presidential prerogative

Venezuela's president, Hugo Chávez, announced proposals to change his country's constitution, which dates from the early years of his rule. They include the abolition of term limits to allow indefinite re-election of the president. Mr Chávez said the changes were necessary to make Venezuela a socialist country. See article

Hundreds of people were reported to have died in **Peru** when a powerful earthquake hit Ica, a prosperous farming area 265km (165 miles) south of Lima.

Cuba's government released two political prisoners, including Francisco Chaviano, who was arrested in 1994 for allegedly revealing state secrets while researching rafters who disappeared or died while trying to flee the island.

Canada's prime minister, Stephen Harper, reshuffled his cabinet. He removed Gordon O'Connor, the defence minister, who had clashed with the army commander, replacing him with Peter MacKay, who had been foreign minister.

Into the sunset

Karl Rove announced his departure from the White House. George Bush's closest political adviser, credited with being “The Architect” of a string of Republican election victories, has received some of the blame for the party's current political woes. The Democrats rejoiced, but said they still wanted Mr Rove to testify in Congress about the sacking of nine federal prosecutors. See article

Mitt Romney won the Republicans' Iowa straw poll, viewed as a measure of organisational strength in the state ahead of their caucus, the first hurdle in the presidential election cycle. Mr Romney took almost 32% of the vote, but the three other leading candidates did not take part and dismissed the result as meaningless. Tommy Thompson dropped out of the race. See article

Meanwhile, Iowa's governor indicated that the preferred date for the state's caucus would remain sometime in early January, and not December as mooted by some. He was responding to the decision by Republicans in South Carolina to change the date of their **primary** to January 19th.

Mr Bush held an informal lunch for Nicolas Sarkozy at the Bush summer home in Kennebunkport, Maine. The meeting of the **American** and **French presidents**, over a menu of hot dogs and blueberry pie, was intended to mark a break with the strained relationship that developed between Mr Bush and Mr Sarkozy's predecessor, Jacques Chirac. Asked by a journalist if he thought Mr Sarkozy would bring cheese to the meal, Mr Bush replied, “I think he's bringing goodwill.”

Reuters

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Business this week

Aug 16th 2007
From The Economist print edition

Financial markets around the world endured another tumultuous week as nervousness spread about the full extent of the credit squeeze. Several **central banks**, led by the European Central Bank, intervened to shore up liquidity by providing short-term cash infusions. In an effort to calm investors, Jean-Claude Trichet, the ECB's president, put out a statement declaring that the money markets were returning "progressively back to normal". But in his first public comments on the situation, Hank Paulson, America's treasury secretary, said he believed the turmoil would slow growth in America, without causing a recession. See article

Stockmarkets in America, Europe and Asia continued to plunge. Investors took fright at an analyst's report that suggested **Countrywide Financial**, America's biggest mortgage lender, might seek bankruptcy protection. Several banks, including UBS, Europe's biggest, said their profits would suffer if the present conditions persisted. See article

Goldman Sachs said it and other investors would inject $3 billion into one of Goldman's quantitative funds that had "suffered significantly" in the market. The firm said it was not rescuing the fund and described the move as an investment. Nevertheless, the news underscored the recent problems encountered by various "quant funds", which trade on the basis of mathematical models. See article

Iceland's **Kaupthing Bank** agreed to buy NIBC, a Dutch merchant bank, for *euro*3 billion ($4 billion). NIBC is one of a number of banks that has reported losses stemming from mortgage defaults in America's housing market. As part of the takeover deal, Kaupthing will avoid that portfolio of debt, leaving it in the hands of NIBC's present owners, a consortium led by J.C. Flowers, a private-equity firm.

Every cloud has a silver lining

Blackstone Group reported that its second-quarter net profit was almost $775m when it released its first earnings statement since making its stockmarket debut in June. The private-equity firm also predicted that the rate of multi-billion dollar buy-out deals would slow in light of the credit markets' difficulties, a situation which, it said, also offered an opportunity to buy debt securities at a discount.

America's two biggest retailers, **Wal-Mart** and **Home Depot**, lowered their profit forecasts for the year, citing the sluggish housing market.

Quarterly net income at **Macy's**, a department store chain that includes the Bloomingdale's brand, slumped by 77%, compared with a year earlier, to $74m. The company (which recently changed its name from Federated Department Stores) acquired May Department Stores in 2005 for $11 billion, but sales have been tepid.

Toy-story two

Mattel's share price fell after it issued a second global recall for some of its toys in as many weeks. This time the company recalled 436,000 toy cars because of "impermissible levels of lead" and up to 18.2m toys containing small magnet pieces that were "potential safety risks". The products were made in China. See article

Nokia said that 100 reported incidents of overheating mobile-phone **batteries** had prompted it to offer replacements to customers. Nokia identified a dodgy batch of 46m batteries supplied by a Japanese firm (but made in China). Last year Sony had to replace 9.6m laptop batteries because of fears they could overheat.

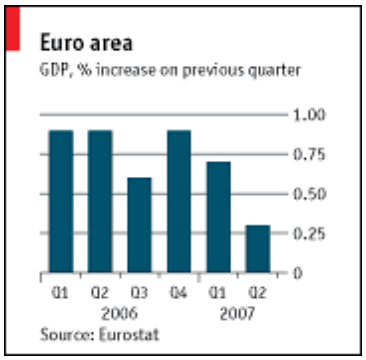
China's inflation rate jumped to 5.6% in July, year-on-year, up from 4.4% in June and its highest level for more than ten years. Rising food prices were to blame; the central bank expressed concern.

Two months after a deal was first proposed, Britain's **Imperial Chemical Industries** agreed to an £8 billion ($16.2 billion) takeover from **Akzo Nobel**, its Dutch rival. To help secure the transaction, Akzo teamed up with Henkel, a German consumer-goods group, to which it will sell ICI's adhesives business (glue products, which include Loctite and Pritt, account for 44% of Henkel's sales). However, the deal must still be approved by Akzo's investors, some of which think Akzo is paying too much for ICI.

One bright spot amid another dismal week for the markets was the stockmarket flotation of **VMware**. The software and data-systems company saw its share price rise by 76% on its first day of trading, drawing comparisons with the successful IPO of another technology company, Google. See article

Warning sign

The rate of economic growth in the **euro area** slowed to 0.3% in the second quarter compared with the previous quarter, raising some doubts about whether the European Central Bank would soon raise interest rates.



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KAL's cartoon

Aug 16th 2007
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Illustration by Kevin Kallaugher

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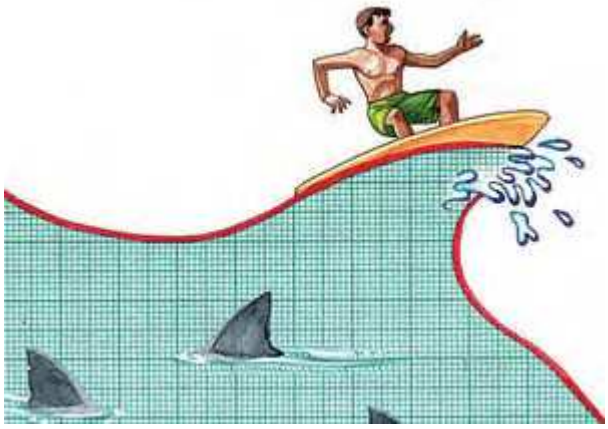
Risk and the new financial order

Surviving the markets

Aug 16th 2007
From The Economist print edition

The new financial order is undergoing its harshest test. It will not be pretty, but it is necessary

Illustration by Jon Berkeley



THE lifeguards had been scanning the horizon for an oil-price shock, a bankrupt buy-out or a terrorist attack. But when the big wave struck last week it surprised them by coming from inside the financial system and threatening to swamp an unlikely shore, the money markets where banks lend to each other to help cover their daily operations. Investors have been asking for years if the frantic innovation in finance, especially the securitisation of just about every form of debt into a tradable asset, was a way to spread risk efficiently, or whether this left the financial system prone to rare—but cataclysmic—failures. It looks as if investors are about to find out.

Over the past week central banks have lent tens of billions of dollars to restore confidence to the markets (see article). But it is already clear that this mess is about more than a bit of rash mortgage lending to Americans who were in the habit of falling behind with their monthly payments. Hedge funds and private-equity firms, kings of the boom, are nursing big losses. Debt markets that once handed out cash to all comers are tight or closed altogether. In almost every asset market, investors are scurrying to reprice risk—which mostly means to reduce it.

The gravest and most immediate threat is to the banking system. For the time being, banks no longer trust other banks enough to lend them money except on onerous terms; equally worryingly, they lack confidence that other banks will trust them if they want to borrow. It is alarming when the very outfits that exist to supply the economy with credit start to hoard it from each other. At best this tightens monetary policy; at worst, a shortage of cash will cripple the payments system and cause runs on otherwise solvent banks and businesses that cannot rapidly raise funds.

Underneath all the new technology and the fancy derivatives with strange acronyms is a dilemma as old as banking itself. Anyone who thinks that lending has been too loose—and many bankers do—should welcome a purge: better now than later when the imbalances would be bigger and the economy probably weaker. But if good banks fail and money for good companies dries up, the purge will wreak huge and wasteful damage on healthy parts of the economy. How likely is that?

Fear of the deep

Financial crises are always about the way people do business, and not just the deals they have struck. Yet this one goes deeper than most. The spreading panic has shown up weaknesses in some of the

foundations of modern finance. The past 20 years have created untold wealth. As securities and markets have steadily taken the place of old-style bank managers, the number of potential investors has grown and the cost of capital has fallen. Much good has come of that.

But there is a price that is only now becoming apparent. Because lenders expected to be able to sell on the risk of default to someone else, they lent too easily. After all, they would not have to pick up the pieces. In theory, that risk should have been borne by the people best able to carry it. But with everybody having sold on the risk to everyone else—and the risk often being carved up, repackaged and sold again—nobody is sure where the losses are. The fear is that some risks ended up with those who least understood what they were getting into, and fear is a potent force in this disintermediated world. In the interbank market, every counterparty was potentially vulnerable. Even small amounts of bad credit can drive out good.

In theory, ratings agencies and mathematical models help investors price the risk they are taking on, even if the securities they are buying are scarcely traded. Yet when some supposedly good-quality assets proved to be worth little, people lost faith in the models and the ratings. Across the board, investors had failed to take account of how fast and how far asset prices fall when everyone wants to sell at the same time. Hard-to-sell long-term securities had been bought with short-lived debt, which left borrowers vulnerable to a change in sentiment every time the debt fell due. It does nothing to restore confidence when the biggest model-driven hedge funds had to get in new money. The people at Goldman Sachs lost a packet when something happened that their computers told them should occur only once every 100 millennia.

Reassess, reprice and then rebound

The retreat to a new level of risk was never going to be orderly or free of casualties. Neither should it be. Bankers and investors need to suffer precisely because the methods of modern finance have been found wanting. It sounds Darwinian, but the brutal demonstration that you pay for your sins is what leads the system to evolve. Markets learn from their mistakes. Only fear will spur investors to price risks better and get them to put more effort into monitoring their counterparties.

If these lessons are to sink in, central bankers must stand back—as, by and large, they have done. Every intervention now will be taken as a sign of what the regulators will do next time. If they bail out banks that have mispriced risk, the mispricing will continue. And when the central banks do step in, it should not be to save the financiers. The cost of intervention is warranted only to save the rest of the economy from the financiers' folly. By that test, central banks were right to lend money to the banks in recent days, because it ensured that a liquidity crisis did not become a solvency crisis. They may yet have to take over a failed bank, though only if that is needed to stop a run. It is still far too soon to cut interest rates.

Because this crisis taps so deeply into the newly devised structures of finance, anyone who says the worst is definitely over is either a fool or someone with a position to protect. As risk has become bewilderingly dispersed, so too has information. Nobody yet knows who will bear what losses from mortgages—because nobody can be sure what those loans are really worth. Nobody knows if tighter lending standards will oblige borrowers to raise more capital, triggering more sales in stockmarkets and more pain. Nobody knows how messy the inevitable bankruptcies will turn out to be. What markets need now is time to piece that information back together. Time before the next wave strikes.

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South Africa and AIDS

Sacking the wrong health minister

Aug 16th 2007
From The Economist print edition

Doubts resurface about Thabo Mbeki's commitment to combating AIDS

AP

Get article background

UNTIL a few years ago it was easy for critics of South Africa's government to lambast its inadequate efforts in fighting AIDS. The country is at the centre of a raging epidemic. Graves fill at a terrifying rate: the disease is now thought to kill 1,000 South Africans each day, most of them young adults. Some 12% of the population, more than 5m people, are infected with HIV, the virus that causes AIDS. For too long the official response had ranged from denial of the problem to the promotion of traditional medicines and barmy dietary remedies, while the central government seemed reluctant to use Western medicines that had proved effective elsewhere. The health minister, for example, suggested as recently as last year that eating beetroot, garlic, lemon juice or the African potato might be the best way to combat the disease.

Thank goodness, therefore, that what appears to be a decent national programme for educating, testing and treating people was at last unveiled in 2003. The benefits are obvious. Most important has been the decision to provide anti-AIDS drugs to more of those who need them. Pills will not put an end to the epidemic, but they keep people with HIV alive much longer and patients become less infectious to others. They may also help to spread knowledge: there is an incentive to be tested for the virus if you can expect to get life-prolonging treatment. Even the government has got political benefits from the treatment programme. Although the president, Thabo Mbeki, still finds it hard for some reason to say that HIV alone causes AIDS, the sting has been drawn from attacks on his leadership by activists and others.

So here is a puzzle. The long-serving health minister, Manto Tshabalala-Msimang, who was largely behind the earlier, ineffective response to the epidemic, remains in post, although she has been ill and unable to work much. Yet her deputy, Nozizwe Madlala-Routledge (pictured above), who is active and well-informed, and who with her boss absent helped to develop the treatment programme, has just been sacked. Mr Mbeki, who has long resisted calls to get rid of the ineffectual minister, has instead removed her effective deputy for, apparently, failing to respect the government's collective will.

Mr Mbeki has rid himself of the wrong health minister. By keeping his old ally Mrs Tshabalala-Msimang in office when she is plainly a liability he has signalled that he values loyalty above competence. He has also provoked doubts, again, about his own commitment to fighting AIDS—not least because Ms Madlala-Routledge's offence appears to have been to dare to travel to an AIDS conference in Spain against his

wishes.

Too candid for the ANC?

Ms Madlala-Routledge was certainly feisty. She was, for instance, fond of visiting hospitals unannounced. Often she witnessed dreadful conditions and poor management—and then talked honestly about these problems in public. To Mr Mbeki and others in the African National Congress-dominated government, this sort of initiative and candour were not evidence of a democratic representative doing her job but of an undisciplined cadre refusing to defer to her bosses, who prefer to discuss such matters behind closed doors.

The question now is whether her sacking bodes ill for the implementation of policy. Ms Madlala-Routledge did not shift policy single-handed, but she was influential. With few ministers willing either to challenge the president or to volunteer leadership on AIDS, for example by taking a public HIV test, her absence will be sorely felt. Mr Mbeki himself should head the fight against the disease. His latest act has done his people, his government and his own reputation no favours at all .

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Latin America's economies

Up from the bottom of the pile

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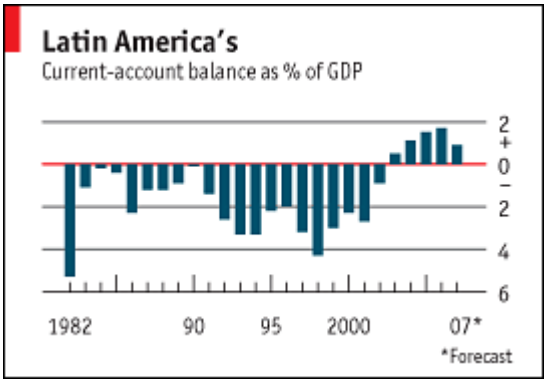
Something rather exciting is happening in Latin America



MUCH of the news coming out of Latin America in recent years has been of radical populists proclaiming "revolution" or, as Venezuela's Hugo Chávez would have it, "21st century socialism". In their widely propagated caricature, a tiny white elite in Latin America oppresses an indigenous majority whose poverty has been exacerbated by the free-market reforms imposed by the IMF and the United States.

So it might be hard to believe that in many countries in the region, and especially in Brazil and Mexico, Latin America's two giants, things are in fact going better today than they have done since the mid-1970s. The region is in its fourth successive year of economic growth averaging a steady 5%. In most places inflation is in low single digits. And for the first time in memory, growth has gone hand-in-hand with a current-account surplus, holding out hope that it will not be scotched by a habitual Latin American balance-of-payments crunch.

What is more, financial stability and faster growth are starting to transform social conditions with astonishing speed. The number of people living in poverty is falling, not only because of growth but also thanks to the social policies of reforming democratic governments. The incomes of the poor are rising faster than those of the rich in Brazil (where income inequality is at its least extreme for a generation) and in Mexico.

In both these countries a new lower-middle class is emerging from poverty (see article). Low inflation, achieved through more disciplined public finances and trade liberalisation, has brought falling interest rates. Credit has at last returned. So these new consumers are buying cars and DVD players or taking out mortgages. No wonder Latin Americans are in an optimistic mood: earlier this year a poll by the Pew Global Attitudes Project found a greater increase in personal satisfaction in Brazil and Mexico over the past five years than in any of the other 45 countries it surveyed.

Keep inflation low and fix the schools

So if things are going so well, why have radical populists and leftists done well in recent elections? Look closer: they have in fact failed to carry all before them. Out of a dozen presidential elections in the region in the 13 months to last December, the radicals won only four. Moderate governments, of centre-left or centre-right, are in charge in most countries.

That said, politics sometimes lags economics. Even as things started to improve, many Latin Americans were in surly mood because they had suffered through five years of stagnation or worse between 1998 and 2003. Besides, the progress is not uniform. In some of the smaller and poorer countries, the populists' caricature has a grain of truth to it. That is why Mr Chávez has friends in places like Bolivia and Ecuador.

But the important point is that the course upon which most Latin American countries are set—of democracy and open-market economies—is finally bearing fruit. The new middle class in countries like Brazil and Mexico derives its income from the private sector, not from public employment. There lies the big difference with Mr Chávez's Venezuela, where falling poverty depends almost entirely on a vast increase in public spending, and is thus hostage to the oil price.

Of course plenty of caveats are in order. The first is that it is not just in Venezuela that growth has been

underpinned by higher prices for commodity exports. Nevertheless, in many other countries export-growth is broad-based. With China and India industrialising, it is unlikely that commodities will be as cheap as in the 1990s any time soon. A second obvious worry is that the current financial-market flap will end up making a serious dent in the growth of the world economy. But—*mirabile dictu*—thanks to its current-account surplus Latin America is not in the front line of this particular market panic.

Another caveat is that for all its recent progress, Latin America remains a long way from enjoying widespread affluence. In the region as a whole, some 38.5% of people remain poor according to national definitions. The gains are still fragile. But the lessons for governments are clear. To bolster the new middle class, it is crucial to keep inflation low. So is improving the shoddy education imparted in the region's schools and universities. And businesses in the region are still held back by lack of transport infrastructure and an excess of red tape.

The commodity bonanza won't last forever, so now is the time to fix these things. Do so and Latin America's democracies could turn an important corner, in which inequality, poverty and populism give way to prosperous middle-class democracies where the majority has an interest in stability.

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Afghanistan and Pakistan

Who is hunting whom?

Aug 16th 2007
From The Economist print edition

Al-Qaeda's border-straddling safe haven, and what to do about it

EVERYONE can see that George Bush's “war on terrorism” is coming to grief in Iraq (see article). Now things are going awry in Afghanistan, too. The United States drove out the Taliban regime in order to deprive al-Qaeda of a safe haven. Nearly six years on, this aim has not been realised.

In large tracts of southern Afghanistan the writ of the elected government of Hamid Karzai does not run and Taliban fighters operate more freely than the NATO forces that prop him up. Worse, this hostile territory crosses the border into Pakistan's Federally Administered Tribal Areas (FATA), home to some 3m people, where the writ of Pakistan's president, General Pervez Musharraf, hardly runs either. And now the general may be losing his grip on Pakistan as a whole (see article). Far from being caught in a pincer between pro-American governments in Kabul and Islamabad, al-Qaeda and its fellow travellers have consolidated a stronghold that encroaches on the territory and may in time threaten the survival of both.

It is important to stress that neither government is in immediate peril. The NATO force in Afghanistan is harrying the Taliban in the south and can certainly protect Kabul. The prospect of Pakistan, a country of 160m people, falling to Islamist extremists is still just a nightmare. But if America and its allies fail to take remedial action now, or if they take the wrong action, the danger of exacerbating the enmity of millions of Muslims in both countries is acute.

Afghanistan's needs are clear: more troops for a NATO effort that has always been under-resourced and so depends on airstrikes that often kill civilians and make more enemies; more effort by the government to reach out to the remote Pushtun tribes who shelter the Taliban; less corruption; a consensual approach to poppy eradication that does not drive farmers over to the Taliban by threatening their livelihoods.

Although Pakistan is more complicated, one certainty is that the idea proposed recently by Barack Obama—sending in American troops against al-Qaeda—would be high folly. Pakistan is not just any Muslim country: it was founded at India's independence as a Muslim homeland. Its people are quick to anger when they feel Islam is under attack. Above all, most of Pakistan is not currently in the jihadists' camp.

That is not to deny there is support for the Taliban (who were Pakistan's allies until General Musharraf's pro-American about-turn after September 11th); and parties with an ideology close to the Taliban's have won power in some areas. But they are a minority. In the 2002 elections the Islamists won only 11% of the popular vote. That would swiftly change if America blasted its way into Pakistan's sovereign territory.

If Candidate Obama has got it wrong, the policy President Bush has pursued also needs new thinking. For the past six years General Musharraf has put on a brilliant show of being America's indispensable ally, holding out against the Islamist tide that would otherwise sweep Pakistan and its nuclear weapons into al-Qaeda's grateful arms. An anxious America accordingly pumps in aid, to the tune of about $1 billion a year. Last month's storming of Islamabad's Red Mosque, which Islamists had turned into an extremist bastion in the heart of the capital, fitted seamlessly into the general's script.

This is not all a show. General Musharraf has indeed arrested many al-Qaeda types and handed some over to America. He sent the army into the tribal areas in an unsuccessful attempt to impose control. Behind the scenes, however, the story has been murkier than the one on stage. General Musharraf has been careful not to alienate the Islamists entirely, and has at times acted as their sponsor. The army and

intelligence services try to root out the sort of jihadists who have tried three times to assassinate the general, but by most accounts continue to hedge their bets against an American failure in Afghanistan by maintaining links to the Taliban.

Until recently America turned a blind eye: better the general you know than the deep green sea of jihadism. But to see General Musharraf as lone defender against the Islamic tide is to misread Pakistan. It is not the Islamists but the moderate mainstream that has lost faith in him. His sacking of the chief justice (since reinstated) and his desire to have himself re-elected by the existing legislatures before the next general election have disgusted voters. America should not give uncritical support to a military ruler who is blocking the return of the democracy that Pakistan appears now both to want and to need. Condoleezza Rice, the secretary of state, was right last week to talk him out of declaring a state of emergency.

The president has worn a uniform too long

Democracy will not cure all Pakistan's ills: the democratic decade from the late 1980s was ruinous. Nor would an elected government necessarily find it any easier to tame the tribal areas. But with authority deserting the general, Pakistan is hungry for a way forward. A democratic government would have to cohabit with the army and maybe also with a (downsized) President Musharraf. It may not do much more to help the West in Afghanistan. But it might start to tackle the grievances that have helped spread al-Qaeda's poison at home.

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The Iraqi “resistance”

When murder is just plain murder

Aug 16th 2007
From The Economist print edition

Never stop saying it's wrong

EPA

Get article background

THERE seems all too little to say apart from the obvious: killing innocents is wrong. But it also feels wrong to pass over in silence, week after week, the repeated atrocities that are killing thousands of civilians in Iraq.

On August 14th suicide-bombers detonated at least four large car and lorry bombs in the villages of Qataniya and Adnaniya, near the city of Mosul in northern Iraq (see article). They killed at least 250 Kurdish civilians belonging to the tiny pre-Islamic Yazidi sect. It is not yet clear who sent these particular bombers or what their motivation was. But what does seem clear is that this attack, like hundreds of others, struck its intended target—neither Iraq's “infidel” occupiers nor the “stooges” of Iraq's army, but ordinary people trying to lead their lives.

Such is their frequency that it has become increasingly hard to keep a tally of either the number of suicide-bombings or the number of victims. On some estimates more than 500 attacks have so far killed or injured more than 4,000 people this year alone. As these quotidian atrocities gradually stop being news, the media (including too often *The Economist*) pass swiftly over the latest murders. It is not surprising. Faced with what looks from afar like a Hobbesian war of all against all, if not a descent into hell itself, the normal instinct of human beings to exercise their moral faculties grows numb. Often it is replaced by a more craven instinct: to avert the gaze from what has become too painful to look at straight.

Even in the hell of Iraq, however, it is important to look at some things straight. And one of those things is that not all kinds of killing are equal. Some are less acceptable than others. This is not a callous or nit-picking legal point: it concerns a vital distinction between legitimate and illegitimate violence that has long been spelled out under the laws and moral requirements of war and must not be fudged.

George Bush is rightly criticised for lumping together as “terrorists” anyone who takes up arms against America or its allies. This is a simplistic formula that blurs necessary distinctions and makes for clumsy policy. Yet some opponents of the superpower's occupation of Iraq make an equal mistake when they lump together—and condone—as “resistance” all of the violent acts committed by America's foes in Iraq.

No excuses

This is profoundly mistaken. Military attacks against foreign soldiers who have come uninvited into your country can certainly be classified as resistance, whether you think such resistance justified or not. But the mass murder of Iraqi civilians can make no such dignified claim. The most lethal atrocities are those carried out by suicide-bombers, most of them from Saudi Arabia, who have imbibed some version of the al-Qaeda idea of war to the end against the unbelievers, who in their minds include Iraq's Shia Muslims. Many Iraqi Sunnis have in their turn been killed—for revenge or as part of a campaign of ethnic cleansing—by Iraqi Shias, sometimes acting alone and sometimes at the bidding of organised militias, often with links to a political party or to Iraq's government.

Under all established norms and laws of war (and by most accounts under Islamic law, too) the deliberate targeting of civilians for no direct military purpose is just a crime. This remains true regardless of the justice of the cause, and whether the killing is done by states, armies, groups or individuals. The world should never tire of condemning such deeds.

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On Phoenix, Claus Schenk von Stauffenberg, global population growth

Aug 16th 2007
From The Economist print edition

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

Phoenix flying high

SIR – Your article on Phoenix misrepresents the city's situation ("Into the ashes", July 28th). Actually, Phoenix is safe: 60% of the city's budget is devoted to public safety. Although it is the fifth-largest city in America, it ranked nearly last—at 98—on the list of America's 100 most violent cities in 2006, according to the FBI. Violent crimes and property crimes, including vehicle theft, are down sharply since 2002. That is remarkable, considering our increasingly diverse population expands by 35,000 people each year.

Contrary to what you imply, Phoenix embraces its rich diversity. More than a quarter of the 1,005 Phoenix residents who serve on the many boards and commissions that help govern the city are minorities, as are 39% of the city's workers. We constantly strive to increase the opportunities for anyone who wants to succeed, and Phoenix's citizens agree. In a recent survey (conducted by an independent research company) nine out of ten residents were either "very satisfied" or "satisfied" with the overall performance of the city in providing services. And 91% of them say Phoenix is a good place to live.

Regarding the light-rail system that is being constructed, Phoenix began working proactively with businesses located along the light-rail line two years before construction even began, offering loans and marketing programmes to help attract shoppers to their stores. Private investors are already pumping more than a billion dollars into new developments along the line. The federal Environmental Protection Agency recently gave Phoenix and METRO light rail an award that recognises smart-growth planning while protecting public health and the environment.

We realise that the opportunity to create a modern city which meets the complex needs of a dynamic population is very rare. Phoenix's citizens, together with leaders from education, government and business, are seizing that opportunity in every possible way. Phoenix is a city that is proudly on the rise—and it will soon soar.

Phil Gordon
Mayor of Phoenix

Michael Crow
President
Arizona State University, Phoenix

German history lesson

SIR – No one can deny the courage displayed by Claus Schenk von Stauffenberg and his associates in trying to assassinate Hitler in July 1944 ("The good German", August 4th). But the attempt was made 11 years after Hitler came to power. It is worth noting that the officer class of which Stauffenberg was a member pledged their support to Hitler after he became chancellor in 1933. They maintained their support when Germany appeared to be winning the war. No significant or effective opposition to Hitler developed within the army until it became clear that he was leading Germany to destruction.

By July 1944 Germany was losing in Normandy and on the eastern front. Hitler's military opponents wanted to get rid of him because he was losing them their war, not primarily because they were anti-Nazi. Had it been otherwise they would have tried more often in the previous 11 years and saved the world from an unspeakable tragedy. I hope Tom Cruise's new film will make that clarification.

Francis de Marneffe
Cambridge, Massachusetts

The pattern of tiny footsteps

SIR – I would respectfully ask *The Economist* to reconsider its dismissal of concerns regarding global population growth ("How to deal with a falling population", July 28th). The world's population is still rapidly increasing by around 78m people a year. This remains a very real concern, with much of the world suffering from increasing water scarcity, land erosion, drought intensity, stalled progress on crop productivity, declining groundwater aquifers, over-grazing of pasturelands, tropical deforestation, massive species extinction, over-fishing, and anthropogenic climate-change. The risks are greatly magnified because all of the projected population increases will occur in less-developed regions that will have great difficulties in absorbing the changes.

The least-developed countries are projected to experience an increase in population from 800m in 2007 to 1.7 billion by 2050, and possibly much higher. With sensible policies and international support, these very poor countries could do themselves a huge favour by reducing fertility rates sharply through voluntary means. The rich countries, on their part, could do themselves and the world a huge favour by putting their efforts into reducing their greenhouse-gas emissions and following through on promised aid, including for universal access to family-planning services, rather than on raising their own fertility rates.

Jeffrey Sachs
Director
The Earth Institute at Columbia University
New York

SIR – Huge numbers of women in the developing world do not have access to the information and means to assert control over if and when they have a child. This is important as rapid population growth is a major factor accounting for failed states.

Consider Pakistan, a country with about 170m people. Some 40% of the population is aged 14 and under. In a generation's time the population will be greater than that of the United States today. There will be almost 25m men aged 15-24 looking for dignified employment and not finding it—prime tinder for extreme politics and religious fundamentalist teachings. As violence increases, perhaps with nuclear weapons, and terrorist cells multiply, maybe someone will leaf through old copies of *The Economist* and smile sadly at phrases such as "Worries about a population explosion have been replaced by fears of decline."

Malcolm Potts
Martha Campbell
School of Public Health
University of California at Berkeley
Berkeley

SIR – You provided an interesting analysis of how specific market factors can indirectly influence population growth. However, your initial assumptions, of undistorted commodity markets and no environmental scarcity, led you to ignore a logical conclusion. The market needs to be directly harnessed towards the goal of stabilising population growth at a sustainable level. This could be achieved through a cap-and-trade system by issuing each adult with 1.05 of a birth permit (ie, 2.1 permits per couple to achieve the replacement fertility rate) and allowing such permits to be tradable.

Adam Drucker
Charles Darwin University
Darwin, Australia

SIR – I am touched that you encouraged governments to leave it up to women in their 20s to make the difficult choice between clubbing and spending "their cash on handbags" on the one hand and child-rearing and buying nappies on the other. The fact that women could be tempted to pursue other choices than the limited ones you gave would normally be considered too superfluous to mention, but judging from the outdated phrasing you used it seems necessary on this occasion.

Eleni Braat
Florence

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Latin America's middle class

Adiós to poverty, hola to consumption

Aug 16th 2007 | SÃO BERNARDO DO CAMPO
From The Economist print edition

Faster growth, low inflation, expanding credit and liberal trade are helping to create a new middle class

Keith Dannemiller

MONTANHÃO takes its name from what it used to be not long ago: a rubbish dump. On the southern extremity of São Bernardo do Campo, a suburb of São Paulo, Montanhão's houses of brick and breeze-block straggle over abrupt hills next to a reservoir. With more than 110,000 people, it is one of the few districts in Brazil's biggest city where the population is still growing fast. It is also one of the poorest. But it is not nearly as poor as it was only a decade ago.

Its winding main street bustles with building-materials depots, gift and clothes shops, restaurants and several small supermarkets. One, called Dia, is part of a discount chain owned by France's Carrefour. Its closest competitor is Mercado Gonçalves, whose owner, Afonso Gonçalves, is a former street-vendor and factory electrician. Since 1997 his little shop has expanded more than fourfold to 480 square metres (5,200 square feet). It sells more than 10,000 separate items, from Nescafé and Colgate toothpaste to fresh meat, freshly baked bread and, locked in a glass case, imported whisky. According to Mr Gonçalves, “A lot of people here are very poor, but a lot are becoming middle class.”

Life in places like Montanhão is still tough. Raw sewage runs in a stream not far from the supermarket. Up on the hillsides, amid a host of evangelical Protestant churches, a few houses are still made of wood. Crime is a big problem. Dora Jozina de Arruda, a young woman who runs a small kiosk on the main street selling sweets and grinding keys, says that she has been robbed twice and wants to move to a quieter neighbourhood. Some residents have clubbed together to pay private security guards to keep drug-traffickers away.

But signs of progress are all around. New tower-blocks, of the kind ubiquitous in the smarter parts of São Paulo, now jut up from among the houses of what still resembles a *favela*, or shantytown. Public services are improving fast: nearly everyone has electricity, piped water and sewerage. Smart new school buses run by the municipal government ply up and down the hillsides. And the mood of optimism is palpable. “Each year has been better than the last,” says Mrs Jozina de Arruda. Between the profit from the kiosk and her husband's wages as a security guard at a bank, they earn $900-1,200 a month.

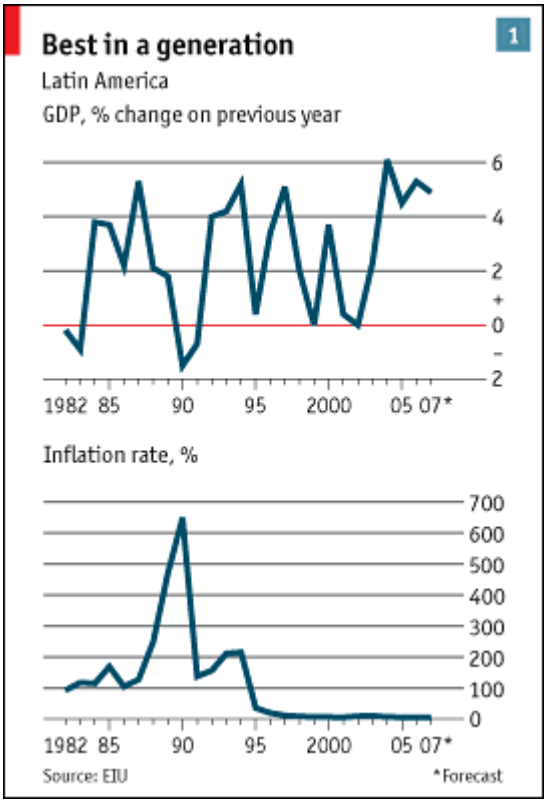
They are members of a new middle class that is emerging almost overnight across Brazil and much of Latin America. Tens of millions of such people are the main beneficiaries of the region's hard-won economic stability and recent economic growth. Having left poverty behind, their incipient prosperity is driving the rapid growth of a mass consumer market in a region long notorious for the searing contrast between a small privileged elite and a poor majority. Their advent also promises to transform the

region's politics.

From the market, not the state

While poverty is measurable, the word “middle-class” is subjective. The kind of people who call themselves middle-class in Latin America tend to be at the top of the scale: prosperous professionals with several servants, children at private schools and holidays in Europe or Miami. From the 1940s to the 1970s, state-led industrialisation and the growth of public employment saw the rise in some Latin American countries of a middle class of managers, bureaucrats and a labour aristocracy of skilled workers. But the policies that pushed them up proved unsustainable; they were abandoned after the 1982 debt crisis, which triggered a decade of mediocre growth and high inflation (see chart 1). Since then, partly because protected industries were subjected to privatisation and import competition, this group has struggled. Marcio Pochmann, an economist at the University of Campinas, reckons that in Brazil 7m people dropped out of the middle class after 1980 (although 3m moved into the upper class).

The middle class that is emerging now is very different. It is more accurately described as a lower-middle class. Fernando Henrique Cardoso, a former president of Brazil who is also a sociologist, points out that this class is related more to the market than the state. Many of its members have small businesses, like Mr Gonçalves. Others act as consultants to larger concerns. José Roberto Mendonça de Barros, an economist in São Paulo, points to a plethora of small service companies which advise large Brazilian farms on computing and biotechnology. The difference is summed up by the changes in São Bernardo do Campo. A generation ago it was the heart of Brazil's car industry, where Luiz Inácio Lula da Silva, the country's president, once led the metalworkers union in strikes. Today the car factories have shrunk or moved away, and São Bernardo lives mainly from services.



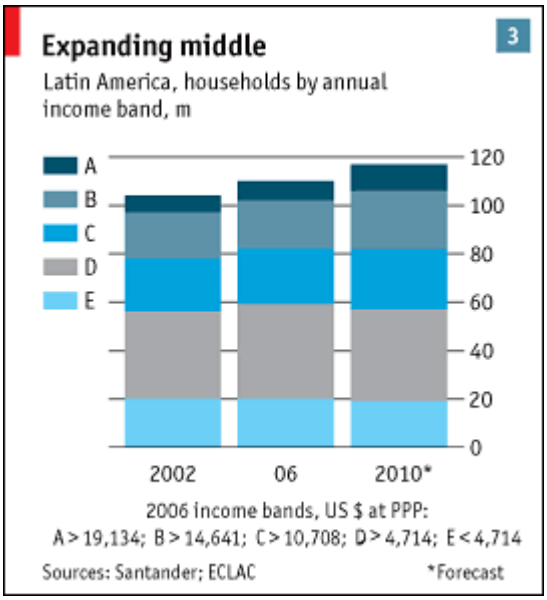
In Mexico, argues Jorge Castañeda, a political scientist, some of the new middle class come from the informal economy, others from new industries or service businesses. The class is less concentrated in Mexico City and is rougher-edged, culturally and socially, as well as darker-skinned, shorter and more Mexican-looking than its predecessor, he says.

These trends are furthest advanced in Chile (see article). But they are most dramatic in Brazil and Mexico, which between them account for more than half of Latin America's 560m people. In Brazil between 2000 and 2005 the number of households with an annual income of $5,900 to $22,000 grew by half, from 14.5m to 22.3m, while those receiving less than $3,000 a year fell sharply to just 1.3m (see chart 2). In Mexico, according to Alejandro Hope of GEA, a consultancy in Mexico City, the number of families with a monthly income of between $600 and $1,600 has increased from 5.7m in 1996 to 10.7m in 2006.

Something similar is starting to happen in Colombia and Peru. In Argentina the decline of what had been a predominantly middle-class country until the 1970s reached its nadir in the economic collapse of 2001-

02, when a majority of Argentines fell below the poverty line. But a rapid economic recovery has been mirrored in a revival of the middle class. Ernesto Kritz, a labour economist in Buenos Aires, reckons that around 40% of Argentine families, up from 20% in 2003, have the monthly income of $1,000 that he sees as necessary for a middle-class lifestyle.

In Latin America as a whole, according to calculations by Banco Santander, a Spanish bank, some 15m households ceased to be poor between 2002 and 2006. If the trend continues, by 2010 a small majority in the region will have joined the middle class, with annual incomes above $12,090 in purchasing-power-parity terms (see chart 3). In Mexico some 15m out of 27m households could have middle-class incomes by 2012, reckons Mr Hope.



The sociology of growth

Several factors lie behind these trends. The first is that, since 2004, the region's economies have grown at an annual average rate of 5%. That is not spectacular, but it is not bad (the population is growing at only around 1.4% a year). And the growth is having a bigger social impact than in the past.

In the early 1990s Latin America saw a burst of growth driven by an inflow of capital and accompanied by overvalued exchange rates. This combination tended to boost the relative price of non-tradable services, and the incomes of those in the informal economy. This period is different, says Guillermo Perry, the World Bank's chief economist for Latin America. Exports are booming, partly because of high prices for Latin America's raw materials. But the export growth also follows a round of devaluations and two decades of market-opening economic reform.

This time the growth is generating more jobs in the formal sector. In Mexico the economy grew by 4.8% last year and created 900,000 new jobs—in line with the growth of the labour force. In Brazil, too, the proportion of the labour force employed informally is starting to shrink.

Another new element is innovative social policies. In both Mexico and Brazil, one family in five now receives a small monthly stipend from the government, provided they keep their children in school and take them for health checks. Lastly, in some countries remittances from Latin Americans who have migrated help their poorer families back home.

The result is that in both Brazil and Mexico the incomes of the poorest half of the population are growing faster than the average. In both countries poverty is falling steadily, and income distribution is becoming less unequal. In Mexico, although growth has been only moderate, poverty, defined as income insufficient to feed a family, fell from 37% to 14% over the decade to 2006.

The figures collated by the UN Economic Commission for Latin America and the Caribbean may understate the regional fall in poverty, since they rely on respondents answering truthfully when asked about their income. Consumption may be a better guide. The other crucial factor that is changing Latin America is low inflation, achieved because most governments have abjured deficit spending and because trade liberalisation has made many goods cheaper. Low inflation benefits the poor more than the rich, who can find ways to protect the value of their incomes. And as interest rates have fallen credit has returned. Credit is still much scarcer than in developed countries, but it is growing fast: in Brazil, for example, the stock of credit has risen to 32% of GDP from 21% in 2002.

It typically starts with consumer loans for cars and durable goods, and moves on to mortgages. In Mexico the value of new mortgages has been growing by around 35% a year. That in turn has stimulated a boom in the building of new housing projects for lower-middle-class families.

Cars, jeans and pampered pets

Sales of new cars, computers and consumer electronics in both Brazil and Mexico are at record levels. Much of the extra demand has come from the new middle class. A study in 2005 of low-income families

in four former *favelas* in São Paulo by the Fernand Braudel Institute, a think-tank in the city, found that all the households surveyed had refrigerators and colour televisions (often more than one), nearly half had mobile phones, 30% had DVD players and 29% owned a car.

Tracy Francis of the São Paulo office of McKinsey, a management consultancy, points out that social classes D to B2 (those with annual incomes from $3,000-22,000) were responsible for 69% of total consumption in Brazil in 2005, up from 51% ten years earlier. The average woman in these social classes has 13 pairs of jeans in her wardrobe, she claims.

They spend on pets, too. “Nowadays people treat their dogs and cats as if they were upper-middle-class: they feed them pet food and take them to the vet,” says Mr Gonçalves. They are also taking to the air for the first time. One cause of the recent problems in Brazil's airline industry has been its rapid growth. In Mexico, Mr Castañeda cites a survey by a new low-cost airline last year which found that 47% of its passengers had never flown before.

All these positive trends are recent and remain fragile. Mr Mendonça de Barros notes that in Brazil, until very recently, a university graduate could expect to earn less than 2,000 reais a month in his first job—roughly the same wage as a bus driver. Many of those who have clawed their way out of poverty could be knocked back down again if there were a repeat of the financial collapses the region suffered in the 1980s and 1990s.

The new middle classes have more schooling than their parents; some have gone to mushrooming private universities. But they are less educated than the old middle class that benefited from elitist public universities—and that makes moving into the upper-middle class hard.

Nevertheless, the direction of change is clear. “We are going faster towards a middle-class society than we could have imagined 20 years ago,” says Mr Cardoso. “My bet is that you're crossing the threshold.”

If so, this carries big implications for politics in the region. Mr Hope finds a close correlation in Mexico between home ownership and support for the ruling centre-right National Action Party. The old middle class believed in state protection. The new middle class is more self-reliant. Above all, it has benefited from economic stability. Since it has much to lose from political adventurism, it could become a force for political stability as well.

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Chile

Destitute no more

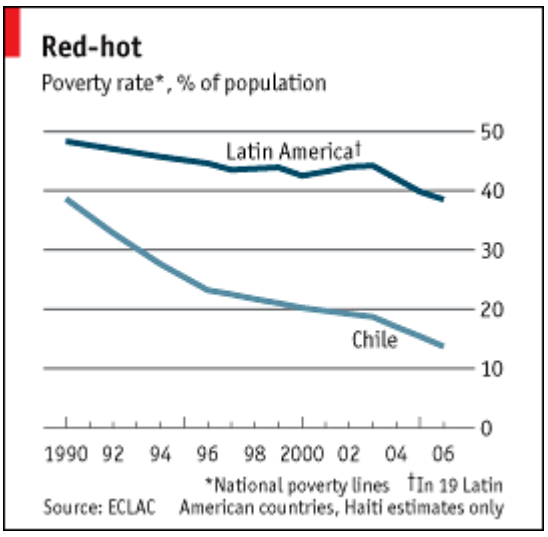
Aug 16th 2007 | SANTIAGO
From The Economist print edition

A country that pioneered reform comes close to abolishing poverty

Get article background

ON ONE of the coldest days in an unusually cold southern-hemisphere winter, Sara Reyes's house is warm. Ms Reyes is sewing the clothes that for the past 18 months have allowed her to support her two children and a nephew, and sometimes to employ a sister and two neighbours. Previously jobless, she obtained her first sewing machine—she now has three—from Chile Solidario, a government programme launched in 2002 to tackle extreme poverty.

Her neighbourhood was once one of the biggest and poorest shanty towns in Santiago, Chile's capital. Over the past ten years, the roads have been paved and piped water installed. Most people now have fridges and telephones and some have cars. “Defeating material poverty is a mission well on the way to being fulfilled in Chile,” says Benito Baranda of Hogar de Cristo, a charity. Its shelters now cater less for the destitute than for people with drug or psychiatric problems. Around 500,000 people still suffer extreme poverty, but that number is down by a third since 2003.



Poverty has fallen further, faster, in Chile than anywhere else in Latin America (see chart). Sustained economic growth and job creation since the mid-1980s are the main explanation, though it helps that poorer Chileans are having fewer children than in the past. In recent years public policies, such as Chile Solidario, have played a bigger role. In the 1990s poverty dropped by half a percentage point for each point of economic growth, but now it falls by one-and-a-half points, according to Clarisa Hardy, the planning minister.

Chile Solidario aims to help the poorest support themselves, by ensuring they take up various social benefits and keep their children healthy and at school, and by offering training and a grant to set up a small business. It is too soon to tell whether it will be a long-term success: the first of 250,000 very poor families enrolled in the scheme are only just graduating from it. Even so, Chile has a chance of all but abolishing poverty in the next few years.

Some Chileans argue that the national poverty line, of $90 a month, is set too low. In Santiago this buys just four bus fares a day. Income distribution in Chile is becoming slightly less unequal. The richest tenth of the population still take 38.6% of national income, though this is slightly less than they take in the United States. Using the relative yardstick favoured in many European countries, 27% of Chileans would be poor, according to Juan Carlos Feres of the UN Economic Commission for Latin America and the Caribbean.

The fact that alternative ways of measuring poverty are now being discussed is a sign of how far Chile has come in the past two decades. It is also an indication of the tasks that still lie ahead in creating a middle-class society.

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The White House

Goodbye to The Architect

Aug 16th 2007 | WASHINGTON, DC
From The Economist print edition

Illustration by Kevin Kallaugher

Karl Rove, George Bush's chief political adviser and close friend, is leaving his job at the end of the month

THERE is nothing unusual about people leaving the White House in the autumn of a two-term presidency. In recent months George Bush has lost his counsellor, Dan Bartlett, his budget director, Rob Portman, his director of strategic initiatives, Peter Wehner, and sundry lesser figures. All to be expected. But Karl Rove's decision to resign on August 31st is news of an altogether different order.

Mr Rove has been at Mr Bush's side for more than 30 years. He masterminded his four successful elections, two for the governorship of Texas and two for the presidency. Mr Bush is so close to him that he has given him not one but three nicknames: “Turd Blossom”, “Boy Genius” and, after the 2004 election triumph, “The Architect”. Nominally, Mr Rove is the deputy chief of staff; in practice, he is far more powerful than that.

Mr Rove's decision to leave set off a frenzy of speculation in Washington, DC. His claim that he wants to spend more time with his family only added to the suspicions, particularly given that his son has just left home for college. And what will happen to the White House without him?

The most plausible explanation for Mr Rove's departure is that he has little to gain by staying. The immigration-reform legislation that he backed has fallen apart. The Bush Team will spend the next 17 months on the back foot, blocking Democratic spending and defending past achievements rather than pushing through fresh legislation. And Mr Rove is the Democrats' equivalent of the great white whale: they want to spend the next few months harassing him over everything, from the politicisation of the Justice Department to the Valerie Plame affair.

At the same time, Mr Rove has plenty to gain by leaving. The Architect is a passionate amateur historian who surrounds himself with memorabilia and history books. His retirement will give him a chance to write his version of the Bush years. Public servants make huge financial sacrifices to stay close to power. Mr Rove will now be able to join the speaking-and-consulting circuit. By this stage in the Clinton presidency, James Carville was making big bucks as a consultant and George Stephanopoulos had written a tell-all book and launched his career as a media pundit.

Mr Rove's departure may have little impact on the president's already limited ability to advance his agenda, but his departure will still have a marked impact on White House morale. Mr Rove was a relentlessly upbeat figure, always able to put a positive spin on dismal news. He is the key member of a tightly knit and fiercely loyal White House staff. And he was Mr Bush's most talented ambassador to the

fourth estate. The White House will seem diminished in the coming months.

Mr Rove's departure has also set off a debate about his legacy. Was he really “Bush's brain”, or just a skilled tactician? Was he the most adept political operative of his generation? Or was he simultaneously malign and incompetent: malign because he practised the politics of division, and incompetent because he designed a presidency that has failed?

Mr Rove says that much of his influence is a myth: he reads about some of the things he's supposed to have done, he told the *Wall Street Journal*, and tries not to laugh. It is important not to overstate his clout. He had very little to do with the most consequential act of the Bush presidency—the decision to go to war with Iraq. His role was limited to selling the war to the press. But he was more than just a skilled tactician. He was at Mr Bush's side for decades. His fingers were all over the policies, not just the press releases. You have to go back to Harry Hopkins in Franklin Roosevelt's White House to find anybody with such a range of responsibilities.

But how good was Mr Rove at his job? The cult of Rove has taken a relentless battering since 2004, thanks to the failure of Social Security reform, Hurricane Katrina, the Harriet Miers fiasco, the Plame affair and the debacle in Iraq. In particular, the Republicans' loss of both houses of Congress in 2006 broke his winning streak and empowered his enemies.

But Mr Rove also had a rare combination of command of the nuts-and-bolts of politics (he had the best mailing list in Texas) and a sharp eye for his opponent's vulnerabilities. He helped Mr Bush defeat a popular Democratic governor, Ann Richards, in 1994, and then win re-election with a huge majority in 1998. He also helped to turn Texas from a Democrat-controlled state into a Republican fiefdom. He transformed Mr Bush into the “inevitable” Republican candidate in 1999, repositioning him as a “compassionate conservative” and a “uniter not a divider” to differentiate him from his rivals. And he eked out a victory over Al Gore at a time of unparalleled peace and prosperity.

That done, he vindicated Mr Bush's victory with a stunning performance in 2004: Mr Bush won more votes than any other president in American history, despite a difficult war and a highly motivated Democratic Party. At the same time the Republicans increased their majorities in both House and Senate—a feat unequalled since FDR's re-election in 1936. A shame the triumph lasted only two years.

Many of Mr Rove's tactical innovations will prove a long-term contribution to the Republican repertoire. Under his tutelage the party did much better at targeting Republican voters, particularly in America's outer suburbs. It also improved its ability to turn out those voters in the final days before an election. Every serious Republican candidate for the presidency employs people who bear the stamp of Rove.

Where Mr Rove failed was with his broader strategic vision of creating a “rolling realignment” and a permanent Republican majority. He believed he could do this by super-charging the conservative base and eating into “Democratic” groups such as Hispanics and young voters. And he used his expanded brief after the 2004 election to pursue his vision.

This lay behind the policy of “big-government conservatism” (a combination of rewards for conservatives and bribes for Democrats). It also underpinned his determination to spend the political capital that had been earned in the 2004 election on Social Security reform.

Yet this vaulting ambition brought disaster. Mr Rove failed to appreciate the degree to which the “politics of division” can lead to a backlash from middle-of-the-road voters. He did not realise that reaching out to Democratic groups can alienate the base—hence the disastrous immigration-reform plan. And he failed to grasp that the only way to get Congress to support far-reaching entitlement reform is to give both sides a stake in change.

The Architect leaves Washington with the Democratic Party resurgent, his own party reduced to an ageing and irascible core, and the president with one of the lowest approval ratings in history. If Mr Rove is indeed planning to spend the next few years working on his memoirs and generally vindicating the Bush presidency, he is in for a busy retirement.

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The primaries

South Carolina strikes again

Aug 16th 2007 | WASHINGTON, DC
From The Economist print edition

The calendar for the first stage of America's election is up in the air

AMERICA'S presidential candidates are in for a bleak Christmas, shuttling between Des Moines, Iowa, and Manchester, New Hampshire. For decades, the Iowa caucuses have been held in January of the election year and followed by New Hampshire's primary. But now several other states want a piece of the early action, and the early two look set to reschedule in order to stay ahead of them.

As so often, the trouble started in Florida. The state was expected to hold its Democratic and Republican primaries on February 5th. But lots of other states also chose that date. Florida, accustomed to outsized influence in national elections, decided it could do better. In May it announced that it would hold its primaries on January 29th.

This, however, robbed South Carolina of its long-enjoyed honour of holding the first primary in the South. So last week Republicans in South Carolina announced that they would move their contest from February 2nd to January 19th. (The Democrats are sticking with the original schedule for now.) Like Florida, South Carolina is used to causing trouble: it was the first state to secede from the Union in 1860.

This, in turn, has created a problem for New Hampshire. By state law, its primary must be held a week before any other. Iowa has a similarly self-serving law: its caucus must come before any other caucus or primary by at least eight days. New Hampshire has not set a new date yet. But if it goes with January 8th—to keep the contest on the customary Tuesday—Iowa would be in the uncomfortable position of having to hold its elections in 2007, which the state's governor says he opposes.

The traditional system—first Iowa and then New Hampshire, followed by other states several weeks later—has been good for those two states. Candidates lavish attention on their voters and pledge allegiance to corn subsidies. Residents, in turn, take their political responsibilities seriously. And the early focus on Iowa and New Hampshire has some benefit to the country. It forces candidates to spend time in small towns rather than millions of dollars advertising in big media markets.

Subject to revision

Presidential primaries/caucuses calendar 2008

Jan	14	Iowa
	19	Nevada, South Carolina (Republican)
	22	New Hampshire*, Wyoming (R)
	29	Florida, South Carolina (Democratic)
Feb	1	Maine (R)
	5	Alabama, Alaska, Arkansas, California, Colorado (D), Connecticut, Delaware, Georgia, Idaho (D), Illinois, Kansas (D), Michigan (R), Minnesota (R), Missouri, New Jersey, New Mexico (D), New York, North Dakota, Oklahoma, Tennessee, Utah, West Virginia (R)
	7	Hawaii (R)
	9	District of Columbia (D)*, Kansas (R), Louisiana,Michigan (D), Nebraska (D), Washington (D)
	10	Maine (D)
	12	District of Columbia (R)*, Maryland, Virginia
	19	Hawaii (D), Washington (R), Wisconsin
	26	Arizona*
Mar	4	Massachusetts, Minnesota (D), Ohio*, Rhode Island, Texas, Vermont
	8	Wyoming (D)
	11	Mississippi, Oregon*
	18	Colorado (R)*
Apr	22	Pennsylvania*
May	6	Indiana, North Carolina*, West Virginia (D)
	13	Nebraska(R)
	20	Kentucky
	27	Idaho (R)
Jun	3	Montana, New Mexico (R), South Dakota

Sources: National Conference of State Legislatures; AP *Considering changing date

But the other 48 states wonder why these two get such a disproportionate say in the nominating process, and why they should not vote sooner themselves. Florida decided to move its primary only after some 20 states, including two other giants, California and New York, signed up for February 5th. But as more states go for early primaries, the others will have to do the same or risk becoming irrelevant. If all the states advance their primaries, America might as well just have a single national primary. Then the candidates could sit in Washington, DC, smoking cigars while consultants ran ads for them.

The current uncertainty over the primary schedule is a hassle for the candidates, who like to plan their pandering in advance. But it will be a boon to future aspirants if it forces America to deal with its broken

primary system. *The Economist* has previously suggested that the process should start later in the year with five randomly chosen states, followed by two or three “Super Tuesdays” on which several states would vote. Someone will have to break the news to Iowa and New Hampshire. And Florida should be given a time-out until it proves that it can be trusted not to mess things up again.

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Newark

A defining moment

Aug 16th 2007 | NEWARK
From The Economist print edition

Violent murders may become an impetus for change

AP

THE lives of very few Newark residents are untouched by violence: New Jersey's biggest city has seen it all. Yet the murders of three young people, who were forced to kneel before being shot in the back of the head in a school playground on August 4th, has shaken the city. A fourth, who survived, was stabbed and shot in the face. The four victims were by all accounts good kids, all enrolled in college, all with a future. But the savagery of the murders, it seems, has at last forced Newarkers to say they have had enough.

Grassroots organisations, like Stop Shootin', have been inundated with offers of help and support since the killings. Yusef Ismail, its co-founder, says the group has been going door-to-door asking people to sign a pledge of non-violence. They hope to get 50,000 to promise to “stop shootin', start thinkin', and keep livin'”. The Newark Community Foundation, which was launched last month, announced on August 14th that it will help pay for Community Eye, a surveillance system tailored towards gun crime.

Cory Booker, who became mayor 13 months ago with a mandate to revitalise the city, believes the surveillance programme will be the largest camera and audio network in any American city. More than 30 cameras were installed earlier this summer and a further 50 will be installed soon in a seven square-mile (18 square-kilometre) area where 80% of the city's recent shootings have occurred. And more cameras are planned.

When a gunshot is detected, the surveillance camera zooms in on that spot. Similar technology in Chicago has increased arrests and decreased shootings. Mr Booker plans to announce a comprehensive gun strategy later this week.

Mr Booker, as well as church leaders and others, believe (or hope) that after the murders the city will no longer stand by in apathy. For generations, Newark has been paralysed by poverty—almost one in three people lives below the poverty line—and growing indifference to crime.

Some are sceptical. Steve Malanga of the conservative Manhattan Institute notes that Newark has deep social problems: over 60% of children are in homes without fathers. The school system, taken over by the state in 1995, is a mess. But there is also some cause for hope. Since Mr Booker was elected, there has been an uptick in investment and a flurry of re-zoning for development. Only around 7% of nearby Newark airport workers used to come from Newark; now, a year later, the figure is 30%. Mr Booker has launched a New York-style war on crime, including zero tolerance of infractions and the setting up of a new narcotics division. So far this year, crime has fallen 11% and shootings are down 30% (though the murder rate looks likely to match last year's high). When Mr Booker was elected, some police stations didn't even have a computer.

The mayor is still battling with a budget deficit and is trying to overcome decades of gross mismanagement. And much is out of his hands. He has no jurisdiction over Newark's county prosecutor, who needs to be tougher. Criminals are back on the streets because of low bail, as was the case of one of the alleged killers, José Carranza, who was freed on bail earlier this year after being charged with assault and with a child's rape. Two 15-year-olds are also being held: the bailed man is an illegal immigrant, which has heightened the national furore. Mr Carranza surrendered to Mr Booker directly. Newarkers must hope that their city does so too.

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Vehicle safety

Too close to nature

Aug 16th 2007 | SEATTLE
From The Economist print edition

All-terrain vehicles are remarkably risky weekend toys

AP

You drove it how fast?

ALMOST every weekend Cornelius “Woody” Peeples, a doctor in Bend, Oregon, sees riders of all-terrain vehicles rushed into the emergency room where he works. Bend is in the heart of a swathe of open, rugged country popular with riders of ATVs—open-cockpit vehicles with powerful engines and knobbly tyres to bounce over rough ground. But often these forays into the wild go awry. “We see deaths or serious injuries,” says Dr Peeples. “The vehicles will roll over onto the drivers, or they'll hit a tree or another ATV and break an arm or a leg.”

Around 13m ATVs are now in use across the United States. Farmers find them handy to haul supplies, hunters use them to get to remote country and youngsters simply like to zoom up and down rough roads. But the little vehicles can be dangerous. In recent years, on average, about 136,000 people have been treated for serious injuries after ATV accidents, according to the Consumer Product Safety Commission (CPSC, a federal agency). Another 750 die.

That number is small compared with the 44,000 people who die on America's roads each year. But many of the deaths and injuries on ATVs involve children under 16: 30% of all injuries and 26% of deaths, according to CPSC figures. In part because of these statistics, the CPSC is developing new guidelines for ATVs, including a ban on unstable three-wheel varieties and greater differentiation between “adult” and “youth” models.

ATV makers such as Yamaha, Kawasaki and Honda are said to support tighter rules. But such regulations will still allow youngsters to ride machines that can race at up to 38mph (61kph). Many doctors would like to see ATV use banned for children of 14 and under.

ATV manufacturers hoping to avoid stronger regulation have found an ally in China. China is exporting to the United States models that are much cheaper than those from Kawasaki, Yamaha and the others. So the big manufacturers are accusing China of exporting unsafe ATVs, though no statistics prove the Chinese models less safe than others.

The CPSC has indeed issued a warning—not a recall—about one Chinese-made model, the Meerkat 50. But, as Rachel Weintraub of the Consumer Federation of America points out, the bigger makers have had their own share of such problems. Yamaha, for instance, recalled 70,000 ATVs in 2005 because of potential steering problems.

Still, on July 18th Ted Stevens, a Republican senator from Alaska, introduced a bill requiring Chinese ATV makers to adhere to American safety standards. It creates the appearance of action, while allowing larger ATV makers to distract attention from the question of stricter controls on themselves.

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California

Where the grass is greener

Aug 16th 2007 | CERRITOS
From The Economist print edition

What one hugely successful city reveals about America

DRIVING along South Street, where the Los Angeles sprawl meets sprawling Orange County, you enter and leave Cerritos three times. Although the city is confusingly shaped, it is easy to tell where it begins. Overhead power cables abruptly disappear and run underground. The grass, watered by innumerable sprinklers, is a brighter shade of green. Indeed, a blind man could tell where the boundary lies. Crossing into Artesia there is a bump, followed by a series of clumsily patched potholes; a few hundred yards later you re-enter Cerritos and the road is smooth again.

Cerritos cannot boast a glorious history, old money or natural beauty. Fifty years ago it was a flat area of farmland known as Dairy Valley. These days, “it's a terribly unremarkable place on the way to Disneyland,” says Tom Irish, a property developer. Yet this small suburban city of some 55,000 people has become remarkable thanks to superb management and geographical good fortune. It reveals much about why America's suburbs are so appealing, and how they are changing.

Like an increasing number of suburbs, Cerritos is both a bedroom community and an economic engine. It began to prosper in the early 1970s when it encouraged car dealers to cluster near the motorway that clips its western edge. Fully 27 outfits now trade there, making it the largest such centre in a car-obsessed state. Cerritos also has a shopping mall and a “towne center”, otherwise known as an office park. As a result, it has far more jobs than working residents. Last year the city collected $483 in sales taxes per person—more than the glitzy city of Santa Monica. And it has leased, not sold, its land, so a future stream of money is guaranteed.

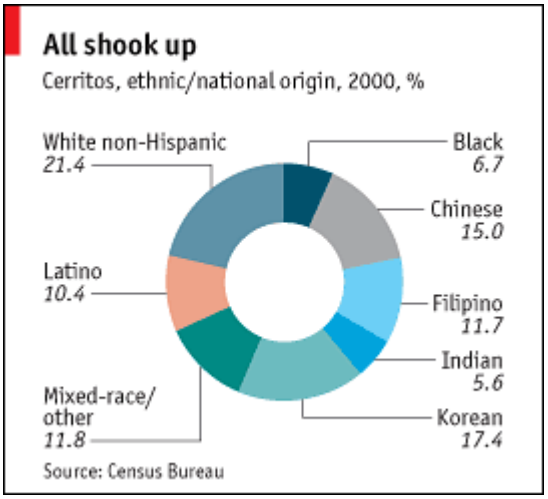
What goes on inside the offices seems less important to locals than what they look like. The city has municipal codes to rival those of notoriously staid Irvine, a planned city in Orange County: don't even think about installing a rotating, blinking or oscillating sign. Sculptures adorn car dealers' forecourts. Cerritos's busy library is covered with titanium; its Wal-Mart is clad in granite. It has an opulent performing arts centre that will host some 140 impeccably populist acts this year.

Building work is underway on the local jail, known for good reason as the “sheriff's hotel”. Although Cerritos has a contract with Los Angeles's county sheriff for its policing, it pays for the building and the officers. They have some of the easiest jobs in California. So far this year 53 serious assaults have been recorded, a bit less than one per cop. The city is so peaceful, says Daryl Evans, the police captain, that gang members from nearby cities occasionally meet there to play basketball, knowing they will not be attacked by rivals.

Of course, many American cities have built parks, performing-arts centres and fancy libraries while struggling financially. The key to Cerritos's success may be the timing of its investments. Cities such as Cleveland and Baltimore poured money into museums and other grand projects in the vain hope that they would lure businesses and young, creative folk. Cerritos began by building pipelines and roads, then moved on to business parks, policing and schools (including California's best high school). Only when it was rolling in money did it break out the titanium.

Local officials attribute the city's success to fiscal discipline and the ability to follow a long-term plan. That, in turn, is the result of its political culture. Cerritos has a tradition of powerful, long-serving city managers, to whom local politicians frequently defer. As Laura Lee, the mayor, explains, “There are many things we, as elected officials, do not understand.” Voters, it seems, like this arrangement greatly. In a 2002 poll, an astonishing 96% of residents said they were satisfied with the provision of public services.

Such single-mindedness is particularly striking given the city's diversity. In 1980 whites comprised more than half of the population. These days Asians do (and a very diverse lot they are, too—see chart). Striving immigrants are cause and consequence of the city's excellent schools: in Cerritos High School, pupils who speak inadequate English score better in mathematics tests than those who speak English fluently. Yet the newcomers have not formed ghettos. The last census showed that whites and Asians were more intermixed in Cerritos than in all but 16 other American cities. Whites were even more mixed-up with blacks and Hispanics.



In this, too, Cerritos is not unusual. James Allen, who follows the movement of ethnic groups at the University of Southern California, points out that middle-class suburbs are now the most diverse places in the region. Rich coastal enclaves remain mostly white. Poor areas, which are mostly Hispanic, are no more diverse. It is in dull, sprawling places with good schools, of the sort ridiculed by Hollywood and detested by urban planners, that America comes together.

These days Cerritos faces strong competition. Its car mall has inspired imitators; as a result, the value of sales has flattened while the number of vehicles sold seems to be falling. As the city ages, public services will come under increasing strain. Drastic decline is unlikely, but the city may be overtaken—though it is almost certain that the places doing the overtaking will be bland, car-oriented and suburban.

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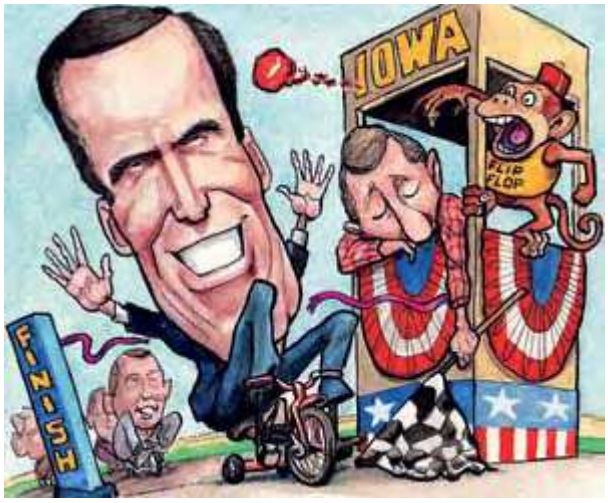
Lexington

Mitt and the monkey

Aug 16th 2007
From The Economist print edition

The Iowa straw poll says more about the state of the Republican Party than about the race for the nomination

Illustration by Kevin Kallaugher



ONE of the odder events in the political calendar is the Iowa straw poll: ridiculous or diverting according to taste. It is not in any sense a representative poll. There are no straws involved. And it is an imperfect predictor of who will win the Iowa caucuses, let alone the Republican presidential nomination.

The straw poll is a cross between a money-raising wheeze for the Iowa Republican Party and a free day at the fair for local conservatives. You have to produce $35 and proof of Iowa residency to vote. But no sensible Iowan picks up his own tab. The candidates pay for the tickets and bus their supporters to Ames, a small town north of the state capital, Des Moines, in air-conditioned splendour. They entertain them to live bands and vast plates of barbecued pork. They even provide bouncy castles and climbing walls for their children. This is more the politics of 18th-century English rotten boroughs than a mature modern democracy, though there were a few suitably modern touches this year. Some ballot papers stuck together because of the excessive heat. A voting machine malfunctioned. And voters had to dip their thumbs in the same sort of indelible ink that is used in Iraqi elections to prevent double voting.

This year's straw poll was even less illuminating than previous ones. Three of the leading candidates—Rudy Giuliani, John McCain and the still-undeclared Fred Thompson—decided that they had better things to do than stuff the people of Iowa with food. But Iowa did underline two important facts about the race on the right: that Republicans are desperately casting around for a front-runner, and that the national party is in a dreadful state, crippled by Bush fatigue but unable to chart a new course. It's not yet a disaster—but it is a disaster in the making.

Mitt Romney suffered frustrating treatment at the hands of the straw pollers. He won 32% of the vote, defeating his nearest rival, Mike Huckabee, by a bigger margin than George Bush beat Steve Forbes by in 1999. But his triumph had already been discounted because of the huge amount of money he had poured into the state (including $2m on television advertising). Mr Huckabee, who spent only about $150,000 and played the bass guitar in his own band at the event, was able to declare himself the “real” winner. An obscure ex-governor of Arkansas who is principally famous for losing 110 pounds (50kg), he is now talked of as a candidate for the vice-presidency.

Mr Romney's ambivalent result is oddly appropriate. His campaign was a masterpiece of organisation. No expense was too large and no detail too small. He had the best barbecue and the bounciest castles. He

had 50 golf carts ready to take his voters from their buses to his tent, which was naturally the biggest and best positioned. His master plan for winning the election is unfolding much as he hoped—to establish a stranglehold on the early primary states while gradually raising his national profile.

But social conservatives remain suspicious of him for his late conversion to the cause of “life”, a label used to lump together opposition to abortion, stem-cell research and euthanasia. The two most prominent social conservatives in the field, Mr Huckabee and Sam Brownback, together polled more votes than Mr Romney did. There is also something off-putting about his campaign—something a bit cultish and a bit hokey. His supporters wore yellow “Team Mitt” T-shirts and waved large mittens (Mitt Mitts) in the air. His five sons were all too reminiscent of the Osmonds. Mr Romney's speech included a bunch of tosh about the American flag that he has used many times before.

Mr Romney also looked out of place among the Ames voters. He is a man who was born wearing a suit. But the Iowa Republicans are not a suit-wearing crowd. They are ideologues who are in politics for the red meat, not the organisational niceties. They wore hats emblazoned with “I'm the NRA and I vote” or T-shirts proclaiming that “Jesus is cool”. They handed out flyers indicting the leading Republican candidates for sexual immorality. One man arrived in a bus painted with the Stars and Stripes and accompanied by a pet monkey in a nappy. “No animal ID”, read one of the innumerable signs on his bus. “Keep your microchips off our animals”.

The crumbling base

The straw poll provided yet further evidence that the Republican base is demotivated. Only about 14,000 people bothered to vote compared with 23,000 in 1999 (no straw poll was held in 2003, as Mr Bush was the only Republican contender). The president's name was hardly mentioned. But it also provided evidence that the party is being taken over by its extremes.

The Iowa crowd was preoccupied by four issues above all else—“life”, taxes, immigration and guns. The loudest cheers went to people who denounced taxes or pledged to build a gigantic fence within their first six months in office (Mr McCain was probably wise to skip the event). Ron Paul won a standing ovation for his plan to abolish the Federal Reserve and return to the gold standard, as well as for a riff that rolled up the neoconservatives, the IMF and the UN into one great ball of evil.

It is hard to remember a time when there was a bigger contrast between what the average voter wants and what hard-core activists desire. Most voters want executive competence after the appalling cack-handedness of the Bush years. But Iowa caucus-goers, who are disproportionately activist, are fixated on a narrow range of ideological tests. Mr Romney's problem is that he is competence on steroids. He turned Bain Capital into a financial juggernaut and made himself $250m. He saved the Salt Lake City Winter Olympics. As governor of Massachusetts, he introduced one of the country's most ambitious health-care reforms. But he cannot dwell upon his real strengths until he first wins over the guys with the “Jesus is cool” T-shirts and the monkeys in nappies. A cruel business, politics.

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Clarification: Terri Schiavo

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In both our leader and briefing on American conservatism last week, we described Terri Schiavo (the extremely ill Florida woman whose life-support system was controversially turned off in 2005) as “brain-dead”; we accept that “severely brain damaged” would have been a better description. The articles have been changed online.

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Brazil's energy policy

Scarcity in the midst of surplus

Aug 16th 2007 | PORTO VELHO
From The Economist print edition

Corbis

Thanks partly to ethanol from sugar cane, Brazil aims to be an energy superpower. But can it keep its own lights on?

THE president, Luiz Inácio Lula da Silva, has just returned from a five-country tour taking in Mexico and Central America, where he touted Brazil's claims to be an energy superpower. Blessed with sunshine, watered by huge rivers and close to self-sufficiency in oil, Brazil's energy potential is indeed enormous. But for various reasons, ranging from government lethargy to environmental lobbies, it runs a serious risk of energy shortages at home.

Acende Brasil, an electricity-industry body, predicts a 28-32% chance of blackouts by 2012 if the economy grows at 4.8% a year (the government's forecast is 5%). Officials dismiss this as alarmist. But Lula is worried enough to have attended a recent meeting of his National Energy Policy Council for the first time.

Even if economic growth disappoints, power could still run short. At present, four-fifths of Brazil's electricity comes from hydroelectric dams. But at times of high demand or low rainfall, hydropower needs topping up with thermal supplies, mostly natural gas. About half of the natural gas consumed in Brazil comes from Bolivia. Relations between the two countries have been tense since Bolivia declared the nationalisation of the Bolivian operations of Petrobras, Brazil's state-owned oil and gas company, last year.

Petrobras has also had problems in ensuring consistent production from its gasfields at home. This month the company admitted that there would be a shortfall in promised deliveries, earning a fine of $90m from the electricity regulator. Uncertainty over future gas supplies meant that at a government auction for new electricity-generation plants held last month only oil-fired projects were proposed.

The government's hopes are pinned on two big projects, both of which have their critics. It recently gave the go-ahead for a third nuclear reactor at Angra dos Reis. Even more controversially, Ibama, the environmental agency, has given approval for two new dams on the Madeira river in the state of Rondônia.

Supporters point out that the two dams will flood an area only one-sixth as large as that inundated by the giant Itaipu dam. But because of their modern turbines, and the strength of the Madeira's flow, they will generate electricity equal to 8% of Brazil's current output.

Opponents predict that the turbines will silt up and that the dams will produce only half the energy advertised. Wesley Ferreira Lopes, of the Movement for Dam Victims, claims that 5,000 families, rather than the official estimate of 900, will be displaced by the dam. His group promises an “uprising” to block the scheme.

If all goes to plan, the Madeira dams should be completed by 2012. But Roberto Smeraldi, of Friends of the Earth, says that every dam project in Amazonia has run between 60% and 120% over its planned construction time. The backup plan is to add thermal energy until the dams can be finished. But from where?

Bolivian gas might have been an option. But, because of the nationalisation, Bolivia may struggle to expand output, despite a deal this month under which Venezuela will invest $600m. Bolivia is committed to expanding exports to Argentina, rather than Brazil. And Bolivian officials are furious about the Madeira dams. They claim these will raise water levels in their country, perhaps encouraging malaria and displacing families and wildlife. After a meeting on August 3rd in São Paulo, Bolivia's deputy environment minister threatened “all necessary measures, legal and international” if the dams go ahead. That could include reducing gas exports.

Brazil insists it has a sovereign right to go ahead with the dams. Evo Morales, Bolivia's president, should stop “sticking his beak” into Brazil's affairs, says Ivo Cassol, the governor of Rondônia.

Another possibility is to generate electricity from sugar cane, in conjunction with ethanol production, though the technology for this is still fairly new. Using sugar cane, Brazil produces far more ethanol per hectare, with fewer emissions, than the United States does with its corn-based equivalent. McKinsey, a consultancy, reckons that if the area under sugar cane were doubled, fertiliser applied and farming mechanised, Brazil's ethanol output would increase from 17 billion litres (4.5 billion American gallons) a year today to 160 billion litres by 2020.

But ramping up ethanol production has drawbacks. Although very little of Brazil's sugar cane is grown in the Amazon region, expanding the crop could put pressure on the rainforest nonetheless, by pushing ranching and soyabean farming farther into the interior.

Environmentalists argue that Brazil could do much more to conserve energy. But that is a long-term effort. The country faces difficult trade-offs between development and the environment. As Jerson Kelman, the electricity regulator, notes, it would be ironic if green opposition to dams means that Brazil ends up using more oil to keep the lights on.

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Mexico and the United States

Plan Mexico

Aug 16th 2007 | MEXICO CITY
From The Economist print edition

Agreement nears on anti-drug aid

Get article background

ON TAKING office as Mexico's president last December, Felipe Calderón made a crackdown against drug gangs his first action. He was prompted by violence that has seemed to spiral out of control in the past few years, with hundreds of murders—and severed heads dumped in public places. He sent the army into nine states, announced a reform of the police—and began talking to the United States about an aid package.

The details are now close to being finalised. An announcement may come on August 20th or 21st at a meeting in Quebec between Mr Calderón, George Bush and Canada's prime minister, Stephen Harper.

Though neither side will be keen to say so, the aid scheme is likely to bear some resemblance to Plan Colombia, under which the United States has given aid totalling some $5 billion over the past seven years. According to Mexico's attorney-general, Eduardo Medina Mora, discussions were still under way but the aid would be geared to equipment and training.

Ever since a 19th-century war in which Mexico lost half its territory to the United States, its politicians have been fiercely touchy about anything that smacks of foreign intervention. In Colombia several hundred American troops have acted as trainers and advisers, though they have not played a direct role in operations. American firms, working under contract to the State Department, have sprayed coca fields with weedkiller.

Mr Medina Mora stresses that Mexico will run all crime-fighting operations on its territory. The government is unlikely to welcome a visible American presence. So the aid is likely to be concentrated on improving the mobility and intelligence capabilities of Mexico's security forces, by providing aircraft, phone-tapping gear and training in infiltration and surveillance techniques. It may also include cash to supplement the miserly salaries that make it so easy for the traffickers to buy off provincial policemen and prosecutors in the often isolated areas they control.

Any aid is likely to have to be approved by the United States Congress, now controlled by the Democrats. They have grown increasingly hostile to Plan Colombia. This has indeed had little impact on the flow of cocaine to the United States. But it has helped Colombia's government to retake control of large areas of the country from guerrillas and paramilitaries.

In recent years Mexico's trafficking gangs have come to control much of the import of cocaine and methamphetamine by the United States, and a large chunk of its distribution north of the border. Mexicans note that their country is paying a high price in violence for the failure of drug prohibition across the border. Officials also point out that the Mexican victims of drug violence are often killed with firearms smuggled in from the United States, where slack gun laws make automatic weapons easy to obtain.

Mr Calderón is claiming that the crackdown is starting to have an effect. But a recent lull in the killings may merely be the result of a peace pact between the two main rival mobs, the Gulf “cartel” and that from the western state of Sinaloa. They are said to have agreed on a division of territory. Even if true, that may not end the violence: 13 drug-related killings were reported in a single day earlier this month.

Any aid package is bound to attract opposition on both sides of the border. Human-rights groups question the use of the army for police work. No amount of aid will improve matters unless Mexico's largely useless police forces undergo radical reform. But many Mexicans may reckon that Mr Calderón is right that those who consume the lion's share of the traffickers' product should help to pay for dealing with their mayhem.

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Venezuela

President for life?

Aug 16th 2007
From The Economist print edition

Forward to six-hours-a-day socialism

Get article background

WHEN Simón Bolívar, South America's Venezuelan-born independence hero, wrote a constitution for the brand new country of Bolivia, it featured a lifetime president. So it should come as no surprise that Hugo Chávez, who claims to be a latter-day Bolívar, is proposing to let himself be re-elected indefinitely to his country's presidency.

The plan to abolish presidential term limits is part of a bundle of constitutional changes unveiled by Mr Chávez on August 15th. These would remove the last remaining checks and balances to presidential power in Venezuela. They would strip the Central Bank of all autonomy, allowing the government to spend the country's foreign reserves. The government would be given power to expropriate private property by decree, and to promote co-operatives and state enterprise.

State governors and mayors will still be subject to term limits—otherwise they might become *caudillos*, Mr Chávez said recently, without irony. They will be sidelined by new communal councils, dependent on the presidency. Another proposal is to reduce the maximum working day to six hours. “Now we are headed straight towards socialism,” Mr Chávez said. But first the plans must be approved by referendum.

In office since 1999, Mr Chávez was himself the architect of the constitution he now wants to modify. Since winning re-election last December he has nationalised the telecoms and electricity industries and discontinued the terrestrial broadcasting licence of the main opposition television station.

The president remains popular, thanks to a bond with many poorer Venezuelans reinforced by quantities of oil money for social programmes. But there is much polling evidence that a large majority oppose socialism and value democracy.

His opponents say that Mr Chávez is destroying Venezuela's economy and its democracy, and needs ever more money to buy popularity. Some of his senior supporters, who have their own presidential ambitions, may also be discomfited by the burgeoning personality cult around the president.

Bolivia quickly discarded Bolívar's 19th-century constitution and sank into instability. Once the oil money runs out, that may be the fate of a socialist paradise working six hours a day.

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Pakistan's politics

The general in his labyrinth

Aug 16th 2007 | ISLAMABAD
From The Economist print edition

AP

General Pervez Musharraf has several options to remain in power, and none looks very promising

Get article background

FOR the price of a telephone call, America endeared itself to millions of Pakistanis when Condoleezza Rice, the secretary of state, rang President Pervez Musharraf on August 8th. Ms Rice was irate. General Musharraf had cancelled a trip to Kabul to attend a *jirga*, a powwow of tribes straddling the troubled Afghan-Pakistani border (see article). He was minded, indeed, to declare a state of emergency the following day—for justification, he had a surge in Islamist violence on Pakistan's side of the border, where America says al-Qaeda has regrouped. Yet Ms Rice advised the general to think again, on both counts. And so he did.

As the general flew to Kabul this week to catch the powwow's closing day, Pakistani pundits praised Ms Rice for safeguarding their democracy. It made a pleasant change. An important ally in the war on terror, whom America has rewarded with $10 billion in aid, General Musharraf has never enjoyed much legitimacy at home. After seizing power in 1999, he ruled as a dictator for three years. Since then, by rigging elections and mangling the constitution to suit his needs, he has ruled as a pretend-democrat for five more. For much of the time, he has at least been fairly popular. Yet this year, with presidential and parliamentary elections looming, his support has collapsed. An opinion poll released on August 14th—the 60th anniversary of the country's founding—showed 65% of urban Pakistanis want him to quit. Without the sort of draconian action that Ms Rice warned him against, General Musharraf may be done for.

The slide began in March, when the general tried to sack Pakistan's chief justice, Iftikhar Chaudhry. An unlikely hero, eccentric and mumbling, Mr Chaudhry refused to go. Instead, he took to the road. Preaching the rule of law, he drew huge crowds wherever he went. Last month, in an unprecedented ruling against a military ruler, the Supreme Court voted unanimously to reinstate Mr Chaudhry. According to his lawyer, General Musharraf, “the blue-eyed darling of the West, must now get used to Western justice.”

If that is so, the political system that General Musharraf devised to keep himself in power has all but collapsed. An incongruous hybrid of democracy and dictatorship, it resembled the cartoons of Heath Robinson, who drew preposterous assemblages of levers, cranks and pulleys, kept running by the tinkering of small bald men in spectacles. For General Musharraf, the Supreme Court's justices routinely performed this function: when asked to weigh the legality of his orders, they ruled in his favour.

Take the case of Shahbaz Sharif, exiled brother to a former prime minister, Nawaz Sharif, also in exile, whom General Musharraf overthrew. In 2004 Shahbaz appealed to the Supreme Court to be allowed to

return home. The court agreed that this was his fundamental right—but said that return he could not. On August 16th the court was due to consider a fresh plea from the Sharif brothers, and Mr Chaudhry has indicated that it will be granted.

If so, according to people in the Pakistan Muslim League-Nawaz Party (PML-N), which Nawaz Sharif leads from London, they will come back in October to fight the election. It was to avoid this that General Musharraf considered calling an emergency, in which fundamental rights would have been suspended and the election postponed by a year.

With Nawaz Sharif back leading his party, General Musharraf might struggle to get a friendly government elected to approve his dictates. The task has until now been performed by the ruling Pakistan Muslim League-Qaid Party (PML-Q), a conglomeration of renegades from the PML-N and Pakistan's other main party, the Pakistan People's Party (PPP). The PPP is led by another exiled former prime minister, Benazir Bhutto. Both opposition parties say that the renegades are returning to the fold. Some 30 parliamentarians from the PML-Q are said to have asked Mr Sharif for election tickets.

This is just the beginning of General Musharraf's troubles. He wants to get himself re-elected president by an electoral college of the current national and state assemblies. Given that the PML-Q and its allies have a majority in all but one of the assemblies, his re-election ought to be assured. But it would be challenged in the Supreme Court, whether or not General Musharraf also tries to remain as army chief—under the constitution, the president may not hold a second office.

In 2002 General Musharraf amended this clause to grant himself a one-off dispensation. He would like to do so again. But constitutional change requires the support of two-thirds of parliament, which he does not have. Alternatively, General Musharraf could try to get re-elected as a civilian. He would then quit the army, either before his tenure expires on November 15th (though he says December 31st), or else he would hope to be re-elected by the next parliament. Either way, he will be at the judges' mercy. The constitution says the president must have held no other public office for two years.

Battened down in his army base in Rawalpindi, General Musharraf is now mulling his options. He can declare an emergency after all, or even martial law. That would send investors packing and Pakistanis onto the streets. The army, which historically has preferred to give up power rather than risk civil strife, might then desert him.

Alternatively, he must amend the constitution, and so he is seeking an accommodation with Ms Bhutto. With the support of the PPP as well as the PML-Q, he would have the required two-thirds majority. On July 27th General Musharraf met Ms Bhutto in Abu Dhabi to discuss a possible deal. He does not like Ms Bhutto and has called her a “thief”. Nonetheless his allies, America and Britain, have long urged him to co-operate with her. They fear the renewed political instability of the sort Ms Bhutto and Mr Sharif oversaw in the 1990s. To prevent it, they want General Musharraf to remain in power as a strong civilian president.

They also want the general to have more liberal support for the social and economic reforms that he has tried with moderate success to push through. Like the PPP, he is secular and moderate by Pakistani standards. As for Ms Bhutto, her needs are simple. She wants to escape a bundle of corruption charges relating to her time in office that the government has filed in Switzerland and Spain. She also wants to scrap a two-term limit on prime ministers, imposed by General Musharraf. After the general's trip to Abu Dhabi, a Musharraf-Bhutto deal looked almost assured. The two are believed to have agreed on several constitutional changes. According to this playbook, General Musharraf would be re-elected by the current parliament in uniform, and would then have to shed it around the end of the year.

Yet as the general's fortunes wane, Ms Bhutto's price may be rising. She now says she cannot support a military ruler. If so, General Musharraf will have to disrobe and hope to fare better than Samson did when he was shaved. Or else, aged 64, he might even think about retirement.

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Afghanistan and Pakistan

Looking for peace on troubled borders

Aug 16th 2007 | KABUL
From The Economist print edition

A powwow, but the chief troublemakers are not invited

Get article background

THE 700 delegates to Kabul's cross-border "peace *jirga*" included the presidents of both Afghanistan and Pakistan, parliamentarians, tribal leaders, clerics and other worthies. The *jirga* generated great displays of headwear, but predictably little of substance on the matter of the ungovernable regions bordering Afghanistan and Pakistan, where the Taliban, and even al-Qaeda, are regrouping. Still, that both sides admitted to a common problem of their territory being used by terrorist groups was progress of sorts.

Strictly speaking, this was not really a *jirga*—a tribal court in which all parties are represented and neutral arbiters pass judgment. For a start, the Taliban, the chief source of trouble, were not even invited. Fazlur Rehman, leader of Muttahida Majlis-e-Amal (MMA), an alliance of religious parties which controls Pakistan's North-West Frontier Province and which is pro-Taliban, dismissed the gathering as merely an "American" *jirga*. The MMA says it will boycott such events unless Western troops pull out of Afghanistan. Thus the gathering was a failure, says Dad Noorani, a political commentator, because it did nothing to bring the Taliban out of the military and into the political sphere.

AP

Supersized headgear, undersized progress

What is more, tribal elders from Waziristan, the centre of the troubles in the Pakistani tribal belt, did not show up, a result of Taliban intimidation. Since 2001 the Taliban have killed hundreds of elders from the border areas, and the cull of influential leaders has weakened the tribal structures that the *jirga* system underpins.

A bad start, then, but at least there were attempts to make a better fist of things. Relations between the two countries had recently deteriorated to the point of playground insults, but leaders were on this occasion more statesmanlike. In particular, Pakistan's president, General Pervez Musharraf, was a good deal franker than many expected when he turned up on the last day to acknowledge that fighting in Afghanistan stemmed largely from "support for the Taliban in areas under our control". In the wake of a number of terrorist attacks inside Pakistan, as well as the government's storming of Islamabad's Red Mosque, occupied by militants, there is a wary hope in Afghanistan that the Pakistani government is at last serious about opposing Taliban-inspired terror.

Enough happened at the *jirga*, then, to begin a formal dialogue over the turbulent border regions, and a follow-up gathering was agreed, to take place in Pakistan. But organic cross-border dialogue also appears to be under way, to judge from the frenzied swapping of mobile-phone numbers among delegates. "The next generation will stone our graves if we do nothing [for peace]", said one.

Still, intractable issues lurk. The Afghan government has yet to convince Pakistan that a return to peace and stability in the border regions will not spark renewed irredentism among local Pashtuns over the disputed Durand Line. No Afghan government has yet accepted the border drawn by Britain in 1893 that runs through the middle of the Pashtun tribal belt.

Meanwhile, Pakistan has yet to act decisively to challenge the Taliban's command and logistics structures on its territory. Nor has it convinced the Afghan side that it has changed its longstanding policy of keeping such pan-Islamicist proxies to counter Pashtun nationalism and further Pakistan's agenda in Afghanistan,

particularly in the face of competing Iranian and Indian influence.

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India's widows

Singing for supper

Aug 16th 2007 | VRINDAVAN
From The Economist print edition

Abandoned women, but at least they're paid to pray

TO THE tinkle of a temple bell, the voices of 1,300 elderly women rise in prayer. “Hare Radha, Hare Krishna,” they chant, in praise of the blue-skinned Hindu God and his consort. “Krishna, Krishna, Hare Hare.” Crammed cross-legged into an ashram in Vrindavan, Uttar Pradesh—where Krishna and Radha are said to have disported—the devotees look mostly bored out of their minds.

But they have not come just for devotion. The women, all in white saris and some with their heads shaved to denote widowhood, are being paid to pray. Before embarking on three hours of mantras, or *bhajan,* each widow receives a red metal token. Afterwards, this is exchanged for three rupees (seven cents) and a handful of uncooked lentils and rice. By chanting *bhajan* morning and evening, for six hours in all, the women make $4.50 a month.

That is only a little more than a state widow's pension of $3.70 a month. But then the ashram, funded by rich Hindus in Delhi, always pays up, which is more than the Uttar Pradesh government can claim. According to a recent survey, only a quarter of the estimated 3,000 pilgrim widows in Vrindavan get their state pension, and usually less than the statutory sum. Fewer than half receive the food ration for which poor Indians are also eligible. As well as chanting *bhajan*, many of the women here and in nearby pilgrimage places beg in order to survive.

It is a state of affairs as old as Hinduism's traditional disdain for widowhood. Unwanted baggage in a patriarchal society, widows were once encouraged to fling themselves onto their husband's funeral pyres. The majority who did not were forbidden to remarry, and often corralled into beggar colonies at pilgrimage places like Vrindavan.

Though the law now gives India's 45m-or-so widows better protection, they are still discouraged from remarrying. Indeed, in Vrindavan nine-tenths of widows surveyed say they are against the practice. That includes many widowed in their youth: two-fifths were married before they were 12 years old, while nearly a third were widowed by the time they were 24.

Most widows are driven to Vrindavan by poverty and cruel relatives. Madhavi Devi, a 70-year-old from Patna in neighbouring Bihar state, says she came to Vrindavan 18 months ago after falling out with the son and daughter-in-law with whom she had been living. “So long as I was nurturing my children I was useful, but now I am old and of no good to anyone,” she says.

Ms Devi, who lives in a government hostel, says that sitting still and chanting *bhajan* for hours is torture, because of a steel pin in her thigh. Yet nearly every widow claims she would rather be in Vrindavan than go home. Indeed, some appear to have found some contentment. One charity, the Guild of Service, houses 120 widows in a crumbling but once-elegant town house. The provisions are basic, yet the stone courtyards are clean and cool, and filled with elderly women chanting mantras—or watching Bollywood movies on a wide-screen television.

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Mental health in China

And now the 50-minute hour

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As living standards rise, so does the demand for mental care

AT HOME and abroad, China's mental-health establishment suffers image problems. Overseas, China has drawn thoroughly deserved criticism for the way it has used police-run psychiatric hospitals as political prisons. At home, the system has long been seen chiefly as a sad but necessary place to cast the severely disturbed or profoundly abnormal.

Things are now changing, at least in China's cities. Rising wealth and expectations of happiness are behind unprecedented demand for counselling as well as psychiatric care. Meanwhile, the mental-health establishment is growing fast, while becoming more professional.

The need for care has presumably long been there. After all, life in pre-reform Communist China was undeniably stressful, with widespread poverty and a series of cataclysmic political campaigns. Yet Zhang Jianxin, deputy director of the Chinese Academy of Science's Institute of Psychology in Beijing, says that urban Chinese now face tremendous pressure to make money and, most importantly, compete with their neighbours for status. The result is a rise in disorders such as anxiety and depression. China's National Centre for Disease Control estimates that 100m Chinese suffer from one form of mental illness or another.

Now, says Dr Zhang, the stigma associated with professional treatment is beginning to fade, along with older attitudes which call on people either stoically to endure problems or to solve them at home. There is still a long way to go. A survey this year by the Shanghai Women's Federation found a majority of the city's families to be grappling with pressure and serious stress. Yet only 2% of respondents acknowledged seeking professional therapy, while only 19% said they would ever consider it.

China's mental-health professionals still fall short. Officials at the Chinese Psychiatrists' Association reckon that China has just 17,000 certified psychiatrists, one-tenth the number in developed countries, in proportion to the population. Mental illness is often diagnosed and treated by general practitioners, who too readily prescribe anti-depressant pills.

As for counselling and other therapies, the profession is still finding its way, with erratic standards. One of the nation's biggest training programmes is designed and managed by the same labour bureaucracy that regulates credentials for cooks, drivers and mechanics.

On the academic track, though, Chinese psychologists are engaging more with foreigners and looking for ways to adapt established theories and techniques to Chinese sensibilities. Dr Zhang says that behavioural and cognitive therapies are proving effective, but Chinese patients seem less comfortable with the Freudian framework, with its emphasis on childhood traumas and deep-seated sexual impulses as the root of many problems.

All that makes sense to Dr Kirsten Thogersen, a Danish psychologist with ten years of experience in China. Western forms of cognitive and behavioural therapy, she says, can work well in the treatment of anxiety or phobias in Chinese patients, because the treatments are geared towards action. But in areas like the meaning of social relationships, things are too heavily based on culture. There, says Dr Thogersen, Chinese social psychologists will come up with interesting theories of their own.

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The Philippines' economy

The Jeepney economy revs up

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Now the country needs to make the most of its luck

Get article background

WHAT distinguishes Manila from other South-East Asian capitals is the ubiquitous Jeepney, the loud rickety bus used by the city's poorer inhabitants. Once modified American Jeeps, nowadays most Jeepneys are cobbled together from second-hand Japanese lorries. They have become a metaphor for the Philippine economy: inefficient and easily overtaken.

In the 1970s the Philippines was richer than its neighbours. Yet while it chugged along at growth rates of around 2%, other countries stepped on the gas: it was passed by Singapore, Malaysia, Thailand and, more recently, by China. A former American colony, it could have made more of its cultural affinities with the United States, including the widespread use of English. The incompetent and crooked rule of Ferdinand Marcos from 1965 to 1986 bears some of the blame for its failure to do so. A sluggish economy combined with a fast-growing population has forced some 8m Filipinos—equivalent to almost a tenth of the resident population—to seek jobs abroad.

The current president, Gloria Macapagal Arroyo, an economist, aspires to see her country join the ranks of the rich world by 2020. Yet her six years in office have been marked by political instability, and progress on reforms has been slow. However, things are looking up. The economy has grown by at least 5% in each of the past three years, for the first time since the 1970s. In the first quarter of this year, growth was 6.9%, year-on-year. Soaring remittances from Filipinos overseas help. Last year they added up to $12.8 billion, equivalent to 11% of GDP. Exports—especially to China and most particularly of microchips—are also booming.

Better economic management also helps. Inflation is now 2.6%, down from 8.6% in 2004. Changes made in 2005 have increased tax revenues without hurting growth. Despite recent wobbles, the government should still come close to balancing the budget next year, compared with a deficit of over 5% of GDP in 2002.

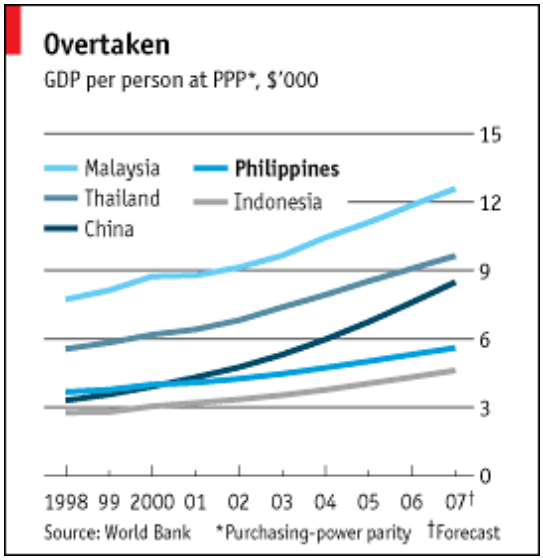
The country's banks, hurt badly in the 1997 Asian financial crisis, have been slow to recover, but now they are starting to lend again. Foreign direct investment is picking up from a low base. Texas Instruments recently chose the Philippines over China for a $1 billion electronics factory, while Hanjin, a South Korean shipbuilder, will spend $1.7 billion on its Philippines yard. Foreign mining firms have started to develop huge untapped mineral reserves.

The Philippines has rapidly emerged as India's main rival in business-process outsourcing (BPO) and now hosts the call-centres of many American firms. A recent study by the Asian Development Bank reckoned that BPO could provide jobs for up to 11% of those joining the Philippines' labour force between now and 2010.

All good news, but worries remain. However welcome the growth in call-centre jobs, it is engineering and business graduates who are queueing to take them. A recent International Labour Organisation study noted that the country's average annual productivity growth between 2000 and 2005 was just 0.9%, compared with 10.3% in China and 4.9% in India, suggesting that “many new job entrants are underemployed”.

A chief problem, despite foreign interest, is a rate of investment that is at 20-year lows as a share of GDP. Poor infrastructure,

especially roads, hampers businesses of all sorts. Gil Beltran, a senior finance-ministry official, says the government intends to increase annual infrastructure spending from 2.8% of GDP to 5%. Successive administrations have had a poor record of keeping such promises.



The public finances still need a lot of fixing. Tax revenues as a share of GDP are still below pre-1997 levels, while public debt is high, at around 75% of GDP. The next big job, says Mr Beltran, is to simplify the mess of illogical tax breaks that cost a fortune in lost revenues. Efforts to drag big-business tax-dodgers to court have so far got nowhere. A swingeing tax rise on Jeepney owners looks like squeezing the poor to spare the rich.

Perhaps a virtuous cycle will develop. The government might boost revenues and spend them on sensible works, so encouraging business, which would boost tax revenues further. It is easier to imagine the Philippines slipping back into complacency, relaxing its efforts and letting this golden opportunity pass by.

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North Korean floods

And then came the flood

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From The Economist print edition

AP

Get article background

North Korea's official news agency tucked the report well below the triumph of Kim Jong Il's “on-site guidance” at the Hamhung Disabled Soldiers' Plastic Daily Necessities Factory, and even the gift of a floral basket that had warmed the Dear Leader's heart. But the torrential rains that have struck the North look devastating, displacing possibly 300,000 people and reportedly ruining one-tenth of the arable land. After a disastrous famine in the mid-1990s, the spectre of food shortages once again haunts the benighted country. Whether Mr Kim and his awful regime will let the outside world help is another matter.

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Israel and Syria

Rumours of war, and peace

Aug 16th 2007 | JERUSALEM
From The Economist print edition

Eyevine

Hey, you, you're making me nervous

Get article background

SOME Israeli security officials think that Syria might want war. Or that Syria might think that Israel wants war. Or that Syria thinks that Israel might think that Syria wants war. And any of these trains of thought could indeed lead to war. Which is why both sides have been preparing for war, while reassuring each other ever more urgently that war is the last thing on their minds.

Israeli predictions of a war this summer began not long after the end of its war last summer, against the Shia militants of Hizbullah in south Lebanon. The fear that Hizbullah would regroup and attack again has been discounted for now; Hizbullah is not yet ready, say Israeli officials, though there is alarm at reports that the Iranian-inspired group is acquiring land north of the UN-patrolled and (supposedly) militia-free zone in south Lebanon, from where they could launch long-range rockets at Israel.

Instead, Israeli sources have for months been drip-feeding the media with speculation that Syria will misinterpret the increase in Israeli army exercises since last year's war as a sign of belligerence. Another popular theory for a while was that Syria would launch a limited attack to force Israel into talks about returning the Israeli-occupied part of Syria's Golan Heights—talks that Israel has rejected since the last set failed in 2000. The speculation has been fuelled by a Syrian build-up of long-range missiles and military positions on the Syrian side of the Golan, just outside the demilitarised area patrolled by another UN peacekeeping force, and by press reports that Syria is now letting its civilians enter the area without special permits. (In fact, says a UN spokesman, that applies to only one destroyed town, which has a few historical sights; visitors to the rest of the area never needed a permit anyway.)

Clearly, Israeli officials are eager to reassure the public that they are prepared for war, unlike last summer. But such talk has also given Syria reason to claim that it is Israel, since it doesn't want peace talks, that is looking for a pretext to strike.

However, Israel now seems to have noticed the danger that its prophecies might become self-fulfilling. In the last few days politicians and senior officers have been insisting that not only do they not want a war, but they also do not believe Syria wants to start one. They now say the Syrian build-up is purely defensive, in anticipation of a possible Israeli attack. Syria's vice-president, Farouq al-Shara, joined the soothing chorus by reiterating that Syria does not want war, though he repeated his belief that Israel does.

So for now the threat may recede. But Israel still suspects that a war will eventually break out, perhaps started by Hizbullah, and that Syria may get dragged in. The question then is what kind of war.

In a conventional war Syria would be hopelessly outgunned. Years of American military aid to Israel—now set to increase by $6 billion over the next ten years—has seen to that. But the success of Hizbullah's guerrilla tactics may have given Syria ideas. A former information minister, Mahdi Dakhlallah, said recently that the next war would not be conventional, but might involve “the resistance” (ie, guerrillas) with support from the army.

Guerrilla tactics defeated Israel in Lebanon. Israel initially relied on air power to attack Hizbullah's rocket-launching crews, and killed hundreds of civilians. It mobilised its ground forces too late, and then made a mad last dash for territory that cost many soldiers' lives but had little impact on the enemy. The new chief of staff, Gabi Ashkenazi, is trying to learn from those mistakes; he is reversing changes made by his predecessor to the command and logistics structures and has been giving reservists extra duty and exercises to make up for their lack of training.

Meanwhile, a government commission has recommended changing the army's financial management so it can spend more on the things that matter. Over the next decade, it calls for cost savings of 30 billion shekels ($7 billion) but also a budget increase worth 46 billion shekels.

Part of that money can come from the American aid increase, of which three-quarters is in the form of credit to buy American-made weapons. And Israel is developing its own anti-missile system to guard against the short- and medium-range rockets that Hizbullah showered on the north of the country. But as Hizbullah showed, advanced hardware is no longer a guarantee of military supremacy. Victory in the future will depend on better intelligence and planning.

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Algeria and terrorism

Threat assessment

Aug 16th 2007 | ALGIERS
From The Economist print edition

Fears grow of an alliance between al-Qaeda and home-grown terrorists

Get article background

IN THE rugged hills of the interior, Algeria's security services have been busy bombarding, encircling, flushing out and killing rebels who are reputed to have joined the nebulous ranks of al-Qaeda. An enthusiastic press reports every twist and turn of the great offensive. In the past three weeks alone, the alleged mastermind of a pair of recent suicide-bombings is said to have been slain, an important emir from the south has turned himself in and dozens of people—mostly rebels, but also a few soldiers—have been reported killed in army crackdowns across the north of the country.

This is the government's latest response to a noticeable increase in terrorist attacks following the forging of an alliance last September between the Salafist Group for Preaching and Combat, the remnants of Algeria's Islamist insurgency in the 1990s, and al-Qaeda. Four months later the Salafist group, better known by its French acronym GSPC, changed its name to the al-Qaeda Organisation in the Islamic Maghreb. After some co-ordinated attacks on police stations and a couple of roadside bombs targeting foreign workers, on April 11th the group claimed a triple suicide-bombing in the capital that hit not only a police station but also the building that houses the offices of both the prime minister and the interior minister. Foreign fighters have also been picked up near the Tunisian border. In July a suicide-bombing struck an army barracks 40 miles (64km) south-east of Algiers, followed a few days later by a prolonged and spectacular night-time shoot-out at a military police station in Kabylia.

April's attacks in the capital prompted a shift in government tactics. For several years, ministers had talked up a peace and reconciliation plan, brushing off terrorism as nothing more than a “residual” problem. But in an independence day speech last month, President Abdelaziz Bouteflika called for the fight against terrorism to be pursued “without reprieve”, heralding the new, more intensive military campaign. The police chief, Ali Tounsi, whose house was targeted in April by a car bomb that failed to detonate, has likened the progress of the security forces to a “steamroller”. The local press, often cosy with the security services, talks frequently of the imminent defeat of the former GSPC, and even of al-Qaeda's failure to implant itself in north Africa generally.

This may be too optimistic. Algeria's insurgency is a shadow of what it was just a few years ago but it has, nonetheless, been given fresh heart by the al-Qaeda alliance. Some of the country's many unemployed and disenchanted youths may have been lured into jihadism by slick propaganda and a global cause.

Despite this, the pattern of the violence so far suggests that Algeria's terrorism is still mostly a local affair, rooted in the bloody civil conflict of the 1990s. Its principal targets remain the army and police and its principal financing comes from local crime, including kidnapping. Little evidence has emerged of operational links between the Maghreb's terrorists and al-Qaeda's global network. Still, the Maghreb is close to Europe. And that makes any scent of al-Qaeda a distinct worry for the wider world.

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Iraq

No one is safe

Aug 16th 2007 | ARBIL
From The Economist print edition

The bombs keep on exploding. The cabinet, too

AP

Another victim of the bombers

Get article background

INSURGENTS struck this week at one of Iraq's smaller minorities, killing at least 250 people and wounding hundreds more in areas populated mostly by adherents of the Yazidi religion in the remote north-west region of Sinjar. Four co-ordinated blasts together constituted the deadliest single attack of the whole war.

Yazidis, most of whom are Kurds, practise a pre-Islamic religion. Because they venerate an angel many Muslims associate with Satan, they are sometimes accused of being devil-worshippers. As part of his notorious Arabisation campaign, Saddam Hussein uprooted Yazidis from their ancestral land, herding them into new “towns” that were initially more like concentration camps. One of those was targeted by the suicide-bombers this week.

They have been hit before. In April 23 were killed after the circulation of a videotape purporting to show a Yazidi girl being stoned to death by co-religionists for converting to Islam to marry a Muslim boy.

But an attack as big as this may have wider significance. Iraq's ethnically fragmented north has seen a surge in bombings in recent months. It may be that al-Qaeda and its allies are seeking new havens there after being displaced by the American “surge” and growing Sunni hostility in central Iraq. Another deadly bombing in the north last month, which killed 150 in the town of Emerli, was blamed on militants fleeing overrun bases.

Ethnic tensions have also been sharpened by the coming referendum on the disputed province of Kirkuk and neighbouring districts. Sunni Arabs and others are nervous about a vote that might result in large swathes of the region joining an autonomous Kurdistan.

Nuri al-Maliki, Iraq's prime minister, is meanwhile trying to put his national-unity government back together. In the past four months three big blocks have left it. They are the radical Shias associated with Muqtada al-Sadr; the secular-leaning Iraqi List of Iyad Allawi, a former Shia prime minister; and the main Sunni coalition, the Iraqi Consensus Front.

Some meetings took place this week between the Shia, Sunni and Kurdish blocks. But it is not clear whether this was a genuine attempt to save a collapsing coalition or just a response to American pleas to

be seen to be doing something about Iraq's fractured politics.

One line of speculation is that this was a final attempt to reach out before the government dispenses with the Sunnis and the most troublesome Shia elements (notably the Sadrists) and forms a cabinet based solely on the mainstream Shia parties and the Kurds. This has a certain appeal. Though the main Shia and Kurdish blocks differ on some points, both agree for now on the need to keep up the fight against the insurgents and to persuade the Americans not to pull out.

Still, to form a government that has no Sunni participation whatsoever would risk antagonising those Sunnis, especially in Anbar province, who have lately grown disenchanted with al-Qaeda's activities in Iraq and have gone over for the time being to the American side. Their switch of allegiance has been much trumpeted by American generals in Iraq and will probably be a prime exhibit in the progress report that General David Petraeus, America's commander, is due to make to Congress in mid-September. He may not be best pleased if Iraq's feuding politicians scramble the message he plans to take to their American counterparts.

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Electricity in Africa

The dark continent

Aug 16th 2007 | DAR ES SALAAM
From The Economist print edition

Power shortages have become one of the biggest brakes on development

SPL

SEEN from space, Africa at night is unlit—as dark as all-but empty Siberia. With nearly 1 billion people, Africa accounts for over a sixth of the world's population, but generates only 4% of global electricity. Three-quarters of that is used by South Africa, Egypt and the other countries along the north African littoral.

The need for more power stations in the rest of the continent has long been recognised, but most of the attempts at electrification in the 1970s and the 1980s failed. In some countries, dictators pillaged power stations for parts and fuel. In others, power stations were built but not maintained. Turbines were run at full capacity until they broke, then were abandoned. By some counts, only 17 of Nigeria's 79 power stations, many dating from this period, are still working; the country's demand for power is an estimated 7,600 megawatts, against an actual operating capacity of 3,500MW. The World Bank reckons that 500m sub-Saharan Africans are without what it calls “modern energy”.

The situation is bound to get worse as the demand for power continues to grow. Africa's relatively healthy economic growth of recent years begets factories and shopping centres—and power cuts galore. Whenever demand outstrips supply, the lights go out—several times during the writing of this story. The ubiquitous exodus from huts to houses only adds to the strains. Even the poorest rural migrants, once in the city, prize electric lighting and television sets, and millions are leaving their villages. Kenya's power utility estimates that it adds 12,000 households a month to the national grid.

For now, the continent remains largely dependent on hydropower: 13 countries use it for 60% or more of their energy. But Africa's rain falls more variably than, say, Norway's, and its dams often operate below capacity. Still, many new dams are being planned. Ethiopia has staked its development on damming the Blue Nile and other rivers. In west Africa dams are due to be built on the Niger, the Volta and Bandama. Some of these projects will be held up by financial and environmental disputes, just as Uganda's 250MW Bujagali dam on the White Nile has been. But most will get built.

The river with the biggest hydro potential is the Congo. The potential demand, too, is huge. Only 6% of Congolese have access to electricity and more power will be needed to get at the country's trove of minerals. A grand project to build a series of dams along the Congo's fast-flowing stretches could theoretically supply 39,000MW, enough to power the entire continent. But that will probably remain a dream. Congo has a terrible reputation among investors, and distributing the electricity across thousands of kilometres, much of it jungle, would pose formidable problems.

Aggreko, a company based in Scotland, is the world's biggest supplier of temporary electricity in the shape of back-up generators. It meets up to 50% of Uganda's power needs, and 10% of those of Kenya and Tanzania. It believes that the global power shortfall in the next decade will be much greater than predicted, perhaps over 500,000MW. The ensuing competition for energy, it argues, will see the world split between those countries whose economies grow faster than their power consumption and those, including most of Africa, whose power consumption grows faster than their economies.

Many African governments are looking at alternative sources of energy to make up their projected shortfalls. Hydropower is clean, from the point of view of greenhouse-gas emissions, but most of the easy alternatives, notably coal, are dirty. Donors committed to cutting global carbon emissions are unlikely to favour more dirty coal-fired power stations of the sort that predominate in South Africa,

although the government there claims that it wants to clean them up. Some fossil fuels, however, are less damaging than coal. A pipeline planned for west Africa, which will carry gas that is now flared off in oilfields, could stabilise electricity supply in coastal cities.

Few Africans in rural areas have access to electricity. Connecting them to national grids will be slow and expensive. Yet Lilliputian windmills, water mills, solar panels and biomass furnaces could have a big collective impact. The cost of lighting a shack takes 10% of income in the poorest households and the kerosene lamps are highly polluting. In response, the World Bank has rolled out “Lighting Africa”, an ambitious effort to get 250m of the poorest Africans on clean-energy lighting by 2030.

Talk of the mass production of biofuels in Africa is premature, but advances have been made. Some investors are backing jatropha, a plant whose seeds produce an oil for burning in generators. There is also an effort to tap geothermal energy. The Great Rift Valley, from Eritrea to Mozambique, could produce 7,000MW. Kenya hopes to get 20% of its energy from geothermal sources by 2017.

Engineers think they can also use the steady winds in Africa's mountain ranges for power production. And if the costs of using the sun's warmth can be reduced to 30% below its present cost, vast solar farms could offer cheap, clean energy for African cities and in doing so boost incomes in rural areas. Egypt, which relies mostly on natural gas, is looking hard at solar power.

Other remedies for Africa's power shortages are more familiar but just as urgent: more efficient appliances, such as LED lighting, more deregulation, better use of existing resources by, for instance, improving the quality of power lines, and pooling power into regional grids. Otherwise Africa will remain in the dark.

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South African politics

The great survivor

Aug 16th 2007 | JOHANNESBURG
From The Economist print edition

Jacob Zuma, presidential hopeful

Reuters

Party man

Get article background

ONCE his country's deputy president, Jacob Zuma has had a rough few years. He was sacked by President Thabo Mbeki in 2005 after his financial adviser, Schabir Shaik, was convicted of fraud and corruption. The following year he was tried for rape. He was acquitted, but then faced charges of fraud and corruption. The case was kicked out of court, but the National Prosecuting Authority may still have another go. The veteran political leader has been ridiculed and vilified, written off by many as politically finished or unfit to rule.

All this would have buried the career of many other politicians. Yet, surprisingly, Mr Zuma, who is still deputy leader of the ruling African National Congress (ANC) party, remains a front-runner to win the presidency of the party in elections due in December. That would make him a virtual shoo-in to be South Africa's next president when Mr Mbeki goes in 2009.

His home in a rich, formerly all-white neighbourhood of Johannesburg feels as laid back as the man himself appears. Local music plays in the background and people casually come in and out. A portrait of himself painted on a goat skin towers over the room from the mezzanine. Wearing an elegant suit and laughing often, Mr Zuma is engaging without being familiar, as well as articulate and imposing. Yet for all the friendliness, the bruises of the past few years show; he offers guarded and careful answers.

Unlike many ANC leaders, Mr Zuma, born into a very poor family in KwaZulu Natal, received little formal education. By 15 he was taking odd jobs to help his widowed mother make ends meet. This, added to his years as a political prisoner and an exile in Zambia, Swaziland and Mozambique during apartheid, partly explains his popularity among the ANC rank-and-file. He is at home among ordinary South Africans, who feel he is one of them. His ease in crowds and at rallies has often been compared favourably to the stiff and cerebral style of Mr Mbeki.

Mr Zuma joined the ANC in the late 1950s, still a teenager, and rose through the ranks to become head of intelligence when the party was underground. His ability to listen and bring people together was instrumental in putting an end to violence between the ANC and the largely Zulu Inkatha Freedom Party in the 1990s. He successfully applied the same negotiating skills in Burundi a few years later.

But then there are the scandals. An investigation relating to a government arms deal from the late 1990s still hangs over him. The lengthy saga has so far not translated into a trial that could either confirm the accusations or put them to rest. Mr Zuma argues that this is unfair, and attributes much of his support within the ANC to the way he has been treated. Critics argue that the more recent Shaik case and the rape trial have highlighted, at best, serious lapses of judgement. Most damaging was his admission in court that he had had unprotected sex with an HIV-positive woman, and had then taken a shower to limit the risks of infection. This was met with outrage and disbelief by many, especially as Mr Zuma had headed the government's official anti-AIDS campaign.

Mr Zuma believes that the court cases in themselves have not tarnished his reputation with supporters, but that the media have damaged his image with the broader public. “They have deliberately made a joke out of me,” he says bitterly. His most ardent supporters, to be found within an eclectic crowd of disgruntled ANC and trade-union members, go one step further and maintain that he is the victim of a political conspiracy.

More worrying is whether Mr Zuma's primary political talent is to say whatever people want to hear, regardless of consequences. He was accused of gay-bashing for comments he made during a speech about traditional Zulu values. He said he was misunderstood and apologised. There are also concerns that the support Mr Zuma enjoys from trade unions and the left of the ANC could lead to a shift in economic policy were he to become president. But for all his apparent outspokenness and gregariousness, the ANC deputy president is, above all, a disciplined party man. “When the ANC decides, the party view becomes my view,” he says, before adding that “One critical thing in the ANC is unity and collective leadership.” A recent ANC policy conference broadly endorsed the current government's economic direction, which has underpinned good macroeconomic performance.

This may explain why business circles do not seem too worried about the prospect of a Zuma presidency. It may also be true that many do not believe he will be South Africa's next president. The ANC branches are about to start debating their choice of nominee for the party leadership. Mr Zuma dismisses questions over whether he would accept a nomination, but characteristically argues that he has never refused any job that the ANC has asked him to do.

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Uganda

A dreaded killer, quickly dealt with

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There are few worse viruses than Marburg

ON JULY 7th a 29-year-old miner at the Kitaka gold mine in the Kamwenge district of western Uganda was admitted to hospital. He died on July 14th. Two weeks later Marburg virus was confirmed as the cause of his death.

An outbreak of Marburg sends a shudder through the select community dedicated to eliminating diseases from the planet. It is an extremely rare and lethal haemorrhagic fever, closely related to Ebola, for which there is no known cure. Its mortality rate, in its most virulent strains, is 90%. Victims die of shock or liver failure within days; often their insides liquefy. Marburg was unknown until a simultaneous outbreak in laboratories in Germany and the then Yugoslav capital, Belgrade, killed seven people in 1967. The outbreak was traced to infected vervet monkeys cut up in the labs for polio research; they came from close to the present outbreak in Uganda.

This time no one was taking any chances. Once the miner's symptoms were noted, local carers put him in a makeshift isolation ward and the Ugandan ministry of health sent in its rapid-response team. Worried experts from the World Health Organisation (WHO) and America's Centres for Disease Control followed. The medics were dressed in germ-warfare suits; the miner's body was safely disposed of and those associated with him were quarantined.

Past outbreaks have been linked to caves or mines frequented by bats; Kitaka has several million of the creatures. A team arrived this week at Kitaka to trap bats from various locations and test them for the virus. The speed with which Ugandan authorities contained the outbreak gives hope that the scientists may be able to improve their understanding of how the virus spreads.

Interest in that extends to some unusual places. The former Soviet Union is thought to have weaponised a strain of Marburg into an airborne powder: a single particle in the lungs could kill. In response, American army scientists and Canada's National Microbiology Laboratory have tried to develop a vaccine.

Virulent diseases are better contained in Africa now than they used to be. The Ugandans managed to cope with the present outbreak largely on their own. The burden of Marburg and other rare diseases is small, says Cathy Roth of the WHO, but their destructive potential drags resources from the fight against AIDS, tuberculosis and malaria. Those diseases still kill thousands of Africans daily.

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Turkey

Presidential troubles, again

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Illustration by Peter Schrank

This time round, Abdullah Gul will surely become Turkey's president—to the annoyance of the army and the secular establishment

THERE was an ineluctable sense of déjà vu this week when Turkey's foreign minister, Abdullah Gul, declared his intention to stand for president. When Mr Gul, a former Islamist, was first nominated for the post by the ruling Justice and Development (AK) Party in April, a political crisis ensued. The army threatened to intervene because of serious risks to Turkey's secular republic. Days later, the constitutional court upheld a case brought by Deniz Baykal, leader of the secular Republican People's Party (CHP), arguing that a first round of parliamentary voting to elect the president was invalid because of the lack of a quorum. Recep Tayyip Erdogan, the prime minister and AK Party leader, was forced to withdraw Mr Gul's candidacy and call an early election on July 22nd, ahead of the scheduled date of November 4th.

In the event AK won almost 47% of the vote, a big jump from the 34% that first took it to single-party rule in 2002. This was a crushing defeat for the generals, who refuse to believe Mr Erdogan's repeated assertions that he and his party no longer mix politics with Islam. Magnanimous in victory, Mr Erdogan was swift to assure Turkey's shell-shocked secular elite that he was sensitive to their concerns. He even pledged to seek consensus when nominating a new president. Many took this to mean that he would choose an AK man with a tamer Islamist past—and one whose wife, unlike Hayrunnisa Gul, does not wear the Islamic-style headscarf, which is banned in all government buildings and schools.

For the army and its backers, the headscarf is an unequivocal symbol of Islamic militancy. To them, a veiled first lady would not only spell the end of Ataturk's cherished republic but also seal the ascendancy of a new, pious bourgeoisie from Turkey's Anatolian hinterland. The army also frets that a President Gul might approve several AK laws that were rejected as unconstitutional by the incumbent, Ahmet Necdet Sezer, a fiercely secular judge. As commander-in-chief of the armed forces, Mr Gul would also have a big say in military and other appointments.

Wary of provoking a fresh confrontation with the generals, Mr Erdogan has tried since the election to douse Mr Gul's presidential ambitions—but he has failed. The question, given his unrivalled authority over AK and his big election win, is why. The other question is how the generals, who have dislodged four elected governments since 1960, will react.

The answer to the first question is now becoming clearer. As Mr Gul himself keeps pointing out, in handing the AK such a big mandate voters were also endorsing his presidential candidacy. Indeed, “Gul for president” was a common refrain at election rallies. The AK has a moral obligation to stand by him, the Gul camp insists.

Several AK bigwigs, notably a former parliamentary speaker, Bulent Arinc, who supported Mr Gul's earlier bid, duly did so again. More important, Devlet Bahceli, leader of the far-right Nationalist Action Party (MHP), which won 71 seats, said his party would take part in a first round of balloting, giving the AK its prized quorum. With 20 Kurdish nationalist members also pledging to show up, Mr Gul is set to become president, if not in the first or second rounds of balloting, which require a two-thirds majority, then in a third round in late August, when a simple majority will be sufficient.

Few doubt that the affable Mr Gul will make a good president. Unlike the reclusive Mr Sezer, Mr Gul is a sophisticated man who speaks fluent English and has lived abroad. As foreign minister, he was the driving force behind the sweeping reforms that prodded European Union leaders into opening membership talks with Turkey in 2005. Even as he has reached out to Turkey's Arab neighbours and to Iran, Mr Gul has worked hard to restore a friendship with America that was bruised by the Iraq war. “Condi [Rice] likes him and trusts him,” says a senior American official.

Mr Gul also promises that defending secularism will be one of his “basic principles”. He has even hinted at a concession: his wife might soon knot the silk scarf that she winds tightly around her head and neck in a hipper style. Atil Kutoglu, a Vienna-based Turkish fashion designer, has been asked to come up with ideas.

If Turkey is really going Islamic, Mr Gul's supporters wonder, why did Saadet, the only overtly Islamist party, scrape a measly 2% of the vote? Nowadays, the Islamic intelligentsia seems less preoccupied with the veil than with whether it is appropriate for pious female Muslims to wear G-string knickers—because, as one luminary has opined, “they keep women in a permanent state of sexual arousal.”

None of this is likely to impress the generals, who say their views on the presidency remain unchanged. Yet “short of an outright coup there is little they can do [to stop Gul],” observes Soli Ozel, a political scientist at Istanbul's Bilgi University. Mehmet Ali Kislali, one of the rare Turkish journalists with good connections in the general staff, disagrees. “They have other means to make their weight felt,” he has argued in *Radikal*, a liberal daily. They could boycott presidential functions, as Mr Baykal's CHP has vowed to do. They could scale down their presence in the presidential palace. More drastically still, they could galvanise the courts into launching a case to close down the AK.

Zafer Uskul, a constitutional lawyer (and one of 150 new deputies recruited by Mr Erdogan to replace more militant party members) may have provided them with ammunition. He has opined that Kemalism (Ataturk's ideology) needs to be “expunged” from a new constitution being drafted by AK to replace the one produced by the generals after their most recent direct coup in 1980. This provoked uproar, and Mr Uskul swiftly declared that his words had been “misunderstood”.

Most commentators concur that, given the scale of AK's victory, the courts cannot touch it without leaving their own credibility in tatters. For the same reason it is hard to see the army stepping in directly. So a more likely outcome is that the generals will be forced to lick their wounds and take Mr Gul on his merits. His record suggests they have nothing to fear—if, that is, they truly believe in democracy.

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Drought in Ankara

Praying for water

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A water shortage that may reflect bad management as much as drought

THE Vatican's ambassador to Turkey, Monsignor Antonio Lucibello, sees building bridges between Islam and Christianity as one of his duties. Last week, he was on a different mission: imploring God for rain, before a congregation of fellow diplomats.

His pleas, echoed by imams in sermons throughout the capital, have yet to be heard. Ankara is experiencing one of the worst droughts in recent history. The city's 4m residents have suffered protracted water rationing: some have had no running water for ten days. Nerves are stretched, as temperatures hover around 40°C. “My wife stinks, my children stink, I stink,” complained Nezih Tatlici, an accountant who said he hadn't had a bath in over a week.

The city's mayor, Melih Gokcek, faces calls to resign after advising citizens to “take a holiday” and, like him, “wash your hair, not your bodies.” What incenses them is that Mr Gokcek blames the water shortage on climate change, even though Turkey's biggest city, Istanbul, is largely unaffected. There is a drought, but Turkey is a mountainous country with lots of water. Reservoirs feeding Ankara have been allowed to fall to only 4% of capacity.

Critics point to mismanagement of resources and poor planning as the real problem. Mr Gokcek has lavished millions on parks and fountains the city can no longer keep going. In Gaziosmanpasa, an upper-class enclave, rows of grass lawns have been burnt dark brown after municipal bans on the watering of gardens. Stray dogs are dropping dead. Hygiene has become such a concern that hospitals are delaying non-critical surgery. Some embassies have rented hotel rooms so that their staff can have a bath; others have postponed official functions. This week Recep Tayyip Erdogan, the prime minister, summoned Mr Gokcek to demand an explanation.

The mayor insists that a project to divert water from the nearby Kizilirmak river, supposed to be finished by November, will do the trick. Meanwhile he says the “only solution” is that “the Almighty gives us rain or snow.” A growing number of residents have a better idea: getting rid of Mr Gokcek.

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Poland's government unravels

Last rites

Aug 16th 2007 | WARSAW
From The Economist print edition

The coalition at last gives up the ghost and prepares for a new election

Get article background

THE Polish government has imploded. The ruling Law and Justice Party has decided to press for an election this autumn, perhaps as early as October. The coalition's demise has been long drawn-out and it will not be mourned. But the antics of Poland's politicians may not encourage high voter turn-out—and even an election might not bring much improvement.

The three coalition parties are busily blaming each other for bringing the government down. The prime minister, Jaroslaw Kaczynski, has now summarily dismissed all four ministers from the junior parties, including a deputy prime minister. Their replacements have improved the government "both intellectually and morally", he declared. He started the ball rolling a month ago by sacking Andrzej Lepper, another deputy prime minister and agriculture minister who heads the Self-Defence party and was implicated in a bribery scandal. Next to go was the interior minister, sacked for allegedly leaking information against Mr Lepper, pitting both men against the zealous justice minister, Zbigniew Ziobro.

The coalition was never a dream ticket. Law and Justice, a party set up by Mr Kaczynski and his twin brother Lech, who is now president, won the 2005 election on an anti-communist, anti-corruption platform. This sat uneasily with its alliance with Self-Defence, best known for cronyism and murky business connections. The other junior partner, the League of Polish Families, attracted ridicule for such acts as seeking an investigation of "Teletubbies", a children's TV programme, because one of the characters might be a homosexual.

Law and Justice had some good ideas, but their implementation was messy. Its main goal was to clean up the sleaze of the previous (ex-communist) Socialist government. But the party resorted to unappealing methods. In trying to uproot all traces of links to the old communist regime, it created a situation in which loyalty was prized above competence. Earlier this year, a colleague of Lech Kaczynski's from his time as Warsaw mayor replaced Leszek Balcerowicz, widely seen as the creator of Poland's modern economy, as governor of the central bank. The independence of the judiciary and the civil service have both been undermined. A negative verdict by the constitutional court on a vetting law was attacked by a Law and Justice deputy who, it seems, was asked to find compromising material on the judges.

Not everything the government has done is bad. It shut the old military-intelligence service, which became a cosy meeting-place for ex-communist spooks. With the help of a good regional minister, its use of money from Brussels, worth some €67 billion ($90 billion) between now and 2013, has become more efficient. The finance minister has struggled valiantly to keep Poland's budget deficit under control, resisting the spending demands of her colleagues. Yet on balance the government's record is poor. The cabinet is a hopeless lot: the only two members with international standing, the foreign and defence ministers, were both forced out to be replaced by Kaczynski cronies. Poland's relations with her European Union partners have been scratchy at best.

Sadly, the opposition is little better. On the right, Civic Platform often lapses into a testy defensiveness rather than promoting its own policies. It has a lead in the polls, but would need a partner to form a government. Despite also being on the right, Law and Justice is an unlikely choice on personality grounds. The alternative may be the Democratic Left Alliance, successor to the Socialists. Yet though revamped by a former president, Aleksander Kwasniewski, and led by a media-savvy 33-year-old, it remains taboo to both centre-right parties. Its support is needed for a two-thirds majority to dissolve parliament, however.

Some observers fret that the outcome could once more put Law and Justice just ahead of Civic Platform, leaving it to scrabble for a humbler partner among smaller parties. That might be good for the Kaczynskis, but not for Poland—nor for the EU.

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Bavarian politics

Et tu, CSU?

Aug 16th 2007 | MUNICH
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Bavaria's Christian Social Union prepares for a post-Stoiber future

FEW people have described Bavarian politics so aptly as a comedian, Gerhard Polt, who once said “In Bavaria we don't need an opposition, we already have a democracy!” That message may resonate with Edmund Stoiber, who is being ousted not by his opposition but by his own party, the conservative Christian Social Union. This may seem surprising, because Mr Stoiber, the longstanding premier of Bavaria and CSU leader, has been a success, as has his state. The party itself is better known for loyalty than rebelliousness.

The roots of Mr Stoiber's demise lie in his greatest triumph. In 2003, a year after he narrowly lost the federal chancellorship to Gerhard Schröder, the CSU won an unprecedented two-thirds majority in Bavaria's parliament. Critics in the party complain that this went to Mr Stoiber's head, as he ignored party bigwigs to push through hurried financial and school reforms. Many rejoiced when he left for Berlin to join Angela Merkel's grand coalition in late 2005; they fretted the more when, in a last-minute huff, he opted out and returned to Bavaria. A simmering discontent boiled over in January after Mr Stoiber was caught up in a snooping scandal. Two senior CSU ministers, Günther Beckstein and Erwin Huber, struck a mutinous deal: Mr Beckstein would be Bavaria's premier and Mr Huber would lead the party.

Now their plan is coming to fruition. Mr Huber faces two rival candidates at the CSU congress in late September, but the smart money is on his becoming party leader. Mr Beckstein is to be installed as premier soon afterwards. Yet the pair might make an awkward double act, with each acting as the other's boss: one in the party and the other in government. This two-hatted leadership may raise doubts about who is really in charge.

Optimists point to the party's historic strength. Founded in 1946 as a more inclusive heir to the Bavarian People's Party, the CSU operates only in that state (by mutual agreement, Ms Merkel's Christian Democratic Union stands in the rest of Germany, but not in Bavaria). It has strong links to Bavaria's elite, and its grassroots reach into the deepest Alpine valleys. Long experience has enabled the party to recruit young talent, helping it to stay in unbroken sole charge of Bavaria for 45 years.

The feuding over the leadership has encouraged tussles at grassroots level as well. Local elections next March will be a trial for the party. The bigger test will be Bavaria's state election in a year's time. Opinion polls today still put the CSU at around 56%. Yet that is almost five points down on 2003; and if a few more votes jump to the Freie Wähler, another conservative regional party, it could clear the 5% hurdle to get into parliament. It is conceivable, if still unlikely, that this could threaten the CSU's absolute majority.

The party is also seeing its influence in Berlin wane. German unification reduced Bavaria's share of Bundestag seats from 18% to 13%. In Ms Merkel's grand coalition the CSU seems an inconspicuous junior partner, with only two ministries—fewer than in any previous CDU-led government. Its two ministers are lightweight, unlike such previous stalwarts as Franz Josef Strauss and Theo Waigel. The CSU's lost clout may be more obvious under Mr Huber, who spurned a chance to head Ms Merkel's chancellery in 2005.

Yet the CSU remains formidably strong in Bavaria. If its plan succeeds, the party will consolidate its power next year before Germany's federal election in 2009, after which Mr Huber may go to Berlin as finance minister. But if it loses any more ground, Bavarians may one day find that they have an opposition after all.

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Albania's government

No power, no glory

Aug 16th 2007 | TIRANA
From The Economist print edition

A tale of corruption and power cuts

Get article background

BAMIR TOPI, Albania's recently elected president, may find himself doing rather more than his job description would suggest. A 50-year-old biologist, he is the first head of the republican state never to have been a member of the Communist Party. He is also one of the country's few senior politicians not to have been seriously tainted by scandal.

The president does not have executive powers, but he has a say in appointing senior members of the judiciary and is also head of the armed forces. Mr Topi, deputy leader of the ruling Democratic Party under Sali Berisha, the present prime minister, has a reputation as a moderate. Could he give Albania's image abroad a boost and help to calm the chronic political in-fighting that came close to wrecking last month's presidential vote and precipitating an early general election?

It took four rounds of voting for Mr Topi to scrape together the three-fifths majority he needed to win. The final vote came after days of behind-the-scenes manoeuvring between Mr Berisha and Fatos Nano, his Socialist predecessor. Mr Nano's own hopes of becoming president were dashed when he failed to win the backing of his successor as party leader, Edi Rama.

The feud between Mr Berisha and Mr Nano, both prominent under Enver Hoxha, is one reason why Albania still suffers from high unemployment and low investment. Albanian migrants working in western Europe and America send home almost $1 billion a year in remittances. Most goes towards building homes and looking after jobless family members. Many Albanians are wary of setting up businesses at home, where licences are given out to political cronies, existing firms use blackmail and intimidation to discourage rivals and the judiciary is corrupt.

Mr Topi's first big task will be to name a new chief prosecutor to replace Theodhori Sollaku, who has been accused of having links with organised crime. Mr Sollaku, who was appointed by the Socialists in 2002, denies this, and his mandate has no expiry date. But Mr Topi is expected to push for a constitutional amendment to set a time limit. He will present this as one of the reforms that are needed for entry into NATO, a goal Albania hopes to achieve at next year's NATO summit in Romania. Without even a remote chance of early European Union membership, Albania is eager to join the other principal Western club soon.

Mr Berisha hopes to attract more foreign investment with his “Albania one-euro” policy of offering sites to foreign companies at minimal rents. But there are likely to be few takers so long as electricity shortages persist. In Tirana this summer, power has been switched off for at least six hours a day; in the countryside, power cuts can last as long as 20 hours. Plans for private investors to build new power plants are way behind schedule. Continuing power cuts are a big reason for a recent dip in the government's popularity and a revival in the Socialists' fortunes.

On the other hand, the economy is growing by about 6% a year. Land prices are rising, especially along the Adriatic coast, as foreigners buy up plots for future development. If the future of Kosovo is settled satisfactorily later this year, the prospects for Albania should brighten.

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Southern Italy

Christ still stops at Eboli

Aug 16th 2007 | ALIANO AND SCANZANO JONICO
From The Economist print edition

Money brings organised crime to Basilicata

THE landscape is the same: arid grey hills dropping steeply to a plain through which the River Agri flows. Even Aliano, a cluster of houses poised above ravines, appears much as it did when Mussolini banished Carlo Levi there in 1935. Of course, a lot has changed since Levi wrote “Christ Stopped at Eboli”, about the people and poverty he found. Aliano today has water, electricity, roads and schools. Public money and private remittances have brought consumer goods. Malaria was beaten 50 years ago. Locals' lives have improved far beyond what Levi could ever have imagined.

But all around are regions racked with organised crime. Puglia has the Sacra Corona Unita, Campania the Camorra and Calabria the worst of the lot, the 'Ndrangheta (this week a feud within the 'Ndrangheta reached as far as Germany, when six Italians were shot dead near Duisburg railway station). Now even Basilicata, with a population of only 600,000, has criminals of its own.

Flourishing fruit farms and a tourist boom along the Ionian coast have been the main lure. “Nobody was aware of what was happening until bombs began exploding. And then there were murders,” laments Filippo Mele, a former mayor of Scanzano Jonico. Police operations have put dozens in jail, but any vacuum is soon filled.

About 100km (60 miles) from Scanzano Jonico, the villages of the upper Agri sit near a big oilfield. Special measures were tried to stop organised crime muscling in when oil production began a decade ago, but the bonanza has brought an inflow of public money. The region and local villages share royalties expected to be worth €750m ($1 billion) over the next 15 years. Oil and coastal rackets are not the only objects of the criminals' interest. Public funds poured in after an earthquake in 1980; EU farm subsidies are another tempting target.

A fog of suspicion also clouds local institutions. On August 6th a judge in Potenza, the regional capital, ordered the suspension of eight officials who had vetted projects for EU subsidies. Even the law is suspect. Last spring the chief prosecutor in Potenza retired early. “Incompatibility with local surroundings” has led to transfers for a prosecutor and the court's president in Matera, Basilicata's second city.

Luigi de Magistris, a magistrate from Calabria whose investigations have shaken Basilicata's magistracy, worries about what is happening. “There is a virus, but no anti-virus. There is collusion between businessmen and politicians of left, right and centre, and within the state there are those who are anti-state,” he says. Alas, where public institutions are absent, weak or worse, it tends to be the organised

criminals who step in to make the law.

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Flying and climate change

Hot topic

Aug 16th 2007
From The Economist print edition

Getty Images

Persuading Britons to cut back on flying will be an uphill struggle

A FIELD next to Heathrow—the world's busiest international airport—does not seem an appealing place for a spot of camping. The roar of jet engines is ever-present, and the only significant landmark is the airport's new control tower. Yet on August 12th dozens of people gamely began erecting tents. They were not there to admire the scenery: this was the Camp for Climate Action, and they had come to protest against aviation and its contribution to global warming.

Old-fashioned anarchists (with their red-and-black flags) rubbed shoulders with their eco-friendly brethren (who fly green-and-black) and with locals worried about plans to expand Heathrow. Veteran all-purpose protesters and disciples of Bakunin mixed with at least one adviser to the Royal Society, two MPs, a local councillor and Vince Cable, the deputy leader of the Liberal Democrats (although, true to the organisers' declaration of withdrawal from mainstream politics, there seemed to be some confusion about who exactly Mr Cable was). Workshops ranged from talks on decentralised power generation and climate science to “Liberation—A Journey Through Buddhism, Anarchy and Ecology” and “Singing to Mourn, to Celebrate and to Resist”. Organisers expect some 2,000 people to pass through the camp before it closes on August 21st.

There were plenty of policemen too, for camp-goers had threatened “direct action” to disrupt the airport during its busiest season. Last year a similar protest hoped to close Drax, a big coal-fired power plant in Yorkshire, and several protesters were arrested. This time, making use of anti-terrorism laws that convey sweeping powers of search and detention, the police had closed roads around the camp and were photographing all the participants. By mid-day on August 16th, ten people had been arrested at Heathrow and ten more at a related demonstration at Biggin Hill, an airport in Kent. They were hauled over for more mundane things, however, such as public-order offences, fraud and theft.

Flying into difficulties

The camp illustrates just what a nightmare climate change has become for those who are charged with putting the aviation industry's best public-relations foot forward. Defenders of the business argue that aeroplanes are being unfairly singled out for criticism. Air travel is thought to account for just 6.3% of Britain's greenhouse-gas emissions, compared with around 20% for road transport and 37% for power generation. But high-altitude carbon emissions are reckoned to be more damaging than low-level ones, although nobody is sure by exactly how much. Airlines are exempt from emissions laws now and pay no fuel tax, and whereas demand for cars and electricity is predicted to grow only slowly, demand for flying is

forecast to rise hugely over the coming decades.

Worries about flying and climate change are not confined to the bearded brigade. A parliamentary group studying the government's proposed climate-change bill has criticised ministers for leaving aircraft emissions out of its targeted 60% cut in greenhouse-gas emissions by 2050, from 1990 levels. The Tyndall Centre, a climate-research outfit attached to the Meteorological Office, Britain's weather forecaster, argued recently that “growth in aviation must be dramatically curtailed.”

Quite how that could be achieved is not clear. Aviation is governed by international agreements that prevent national governments from imposing fuel taxes. Even if the legal niceties could be sorted out, there is no agreed way of assigning emissions from international flights to specific countries. Unilateral fuel taxes look impractical: most short-haul airlines would simply refuel abroad. And although renewable energy, nuclear power or biofuels can help cut emissions in other sectors, scientists have yet to come up with an alternative to jet fuel.

To their credit, ministers have pledged to try to get flying included in the European Union's Emissions Trading Scheme, a cap-and-trade arrangement for discouraging reliance on carbon. But greenery is not the government's only priority. Two recent government-backed studies point in opposite directions. Sir Nicholas Stern's mammoth report on climate change made a powerful case for cutting carbon emissions immediately. Sir Rod Eddington's equally weighty review of Britain's decrepit transport network recommended bigger airports and more roads.

The Conservatives appear divided too. David Cameron, the Tory leader, has worked hard since coming to office to project a diffuse green warmth, but a recent report from John Redwood—a former cabinet minister charged by Mr Cameron with thinking big thoughts about economic competitiveness—prescribed a big expansion in road and air capacity.

Luckily for politicians, the public looks unlikely to punish them for their dithering. Flying, especially on the short breaks pioneered by low-cost carriers such as easyJet, is hugely popular. EasyJet's passenger numbers have risen by 200% over the past five years, and most of its competitors are doing just as well. Even Tony Blair, the former prime minister who described climate change as “perhaps the greatest challenge facing our world”, said on his way to Barbados in January that he was not prepared to give up foreign holidays.

Britons do seem to regard climate change as a problem, but there is little appetite for big lifestyle changes. One recent poll by Ipsos MORI found that most respondents were doing nothing to reduce their carbon emissions. In another survey, for the *Sunday Times*, 70% of people reckoned that greenery would drop right down the political agenda if economic growth stalled.

That latter result will be particularly worrying for the climate campers. The government believes economic growth is the strongest driver of demand for air travel. The protesters think so too, and conclude that economic growth must therefore come to an end. That view has the virtue of being admirably clear-eyed, but as a political sell, it looks rather tricky.

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Aer Lingus

A wing and a prayer

Aug 16th 2007 | BELFAST
From The Economist print edition

A row over routes is re-stoking north-south rivalries

THREE years ago, despite its brave name, Belfast International Airport boasted just one scheduled international flight a day; and it demolished the last of its anti-IRA perimeter checkpoints only this spring. But from next January, it will be an Irish regional hub for flights all over Europe, including, most importantly, London's Heathrow. The row that has broken out over this development reflects unease over the changing economic alignment between north and south that peace in Ulster is bringing.

The surprising source of Belfast's expansion is Aer Lingus, Ireland's national airline for 70 years until it was privatised in 2006 and still, for many, a potent symbol of national identity. The firm plans to shift its Heathrow service from Shannon Airport, in the west of Ireland, to Belfast. There it will revive a route abandoned by British Airways when air travel fell off after the terrorist attacks in America in 2001. Though some airlines continued to fly the route, many unionists felt their Britishness diminished by BA's relinquishing of the link. How do they feel now that it is to be restored by aircraft with shamrocks on their tail fins and names associated with Irish saints on their bodies?

The fundamentalist Protestant preacher Ian Paisley was all smiles when the deal was announced, for it may bring a million new passengers a year to an airport that now handles 5m. The first minister kept smiling as Dermot Mannion, Aer Lingus's boss, said the move would encourage the growing economic relationship “between the north and south of the island of Ireland”.

But people south of the border are less chuffed. Businessmen, unions and church leaders claim that development in Ireland's underpopulated west will be damaged if Shannon loses worldwide connections through London. Word that pay and conditions for the 100 pilots and cabin crew Aer Lingus expects to hire for Belfast might be worse than in the Republic caused the airline's existing pilots to threaten a strike on August 21st and 22nd. And Michael O'Leary, who runs low-cost Ryanair, Ireland's biggest carrier, is stirring the pot. The owner of 25.2% of Aer Lingus's shares, Mr O'Leary called on August 14th for shareholders to block its shift from Shannon. He hopes to get support from the Irish government, which still owns over 25% of the airline's shares, and the firm's unions and employees, which hold around 15%.

Politicians may be slower to back him than he hopes, however. A poll in the Irish-American *Irish Echo* found that 57% of readers would fly into Belfast rather than Dublin if fares were lower. Financial advantage can be relied upon to trump national sentiment, it seems.

Back in Belfast, unionists no longer scoff that co-operation across the border can never work to Northern Ireland's advantage. The “extremely hostile reaction” in the south to Shannon's loss emphasises the importance of Belfast's gain, says an MP from the Democratic Unionist Party. Under its new owner—a Spanish firm, Albertis—the airport had already upgraded its runways and buildings, which helped it to win Aer Lingus against competition from busy Birmingham. More deals to come?

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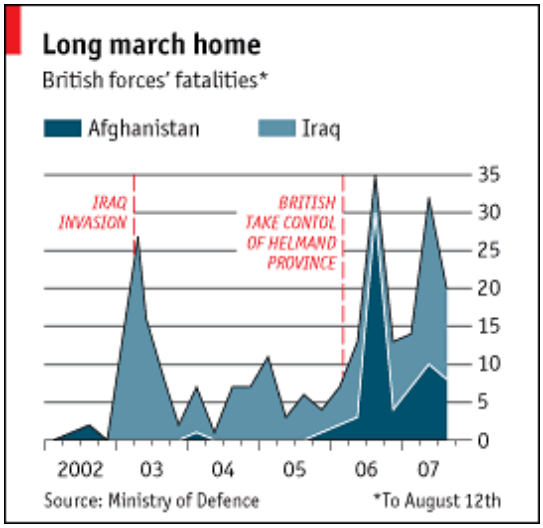
Iraq and Afghanistan

Britain's neglected wars

Aug 16th 2007
From The Economist print edition

The strange quiescence of Britain's anti-war movement



ON THE Ministry of Defence's website is a growing list of the young men and women who have died fighting for Britain in Iraq and Afghanistan. Their photographs, which show tanned soldiers smiling into the camera against clear skies and dust, give little indication that Britain is fighting some of its fiercest battles since the Korean War. But the frequency of their posting points to the rising price that is being paid for an honourable exit from Iraq, and to defeat the Taliban in Afghanistan.

British casualties in both conflicts have jumped from a monthly average of five between 2004 and 2006 to eight so far this year. More servicemen and women have already died in 2007 than in all of 2003, when Iraq was invaded (see chart).

But rising casualties have not been translated into the public displays of discontent that might have been expected. The most vocal campaigns have been mounted by soldiers' organisations, which, though they do not oppose the wars, argue that Britain is letting its soldiers down. On August 15th the Royal British Legion, a venerable veterans' charity, spoke of a “growing sense of disillusionment among service personnel and veterans about their treatment by the state”.

Strangely, Britain's once-vociferous anti-war movement has become more muted as ever more flag-draped coffins return home. While the troops were preparing to invade Iraq, between 750,000 and 2m protesters gathered in London for Britain's biggest demonstration against anything ever. But by 2005 organisers were struggling to mass more than 10,000, according to police estimates (organisers claim more), and their most recent big event, in February 2007, drew no more.

So why has anti-war sentiment been relatively muffled in Britain when in America it is defining the presidential elections, and in Canada, Italy and Germany it has prompted heart-searching national debates about whether to bring the troops home? The wars are no more popular in Britain than they are among its allies: far fewer Britons than Americans have ever thought the war in Iraq a good idea. Support in Britain peaked at 60% right after the fall of Baghdad in 2003, and at 73% in America. It has since dwindled to 30%, against around 40% in America.

One difference between the two countries is the scale of the involvement. As America has built up its forces in Baghdad to about 160,000 soldiers, Britain has cut its troops back to around 5,500 (from a peak of 46,000 in 2003). Fewer soldiers in harm's way has meant fewer anxious families back home and kept British casualties much lower than America's.

The war feels distant for most Britons for another reason too. Pollsters at the Pew Research Centre discovered that 27% of Americans have a close family member or friend who has served in Iraq or Afghanistan, whereas a recent YouGov poll found that only 18% of Britons have friends or relatives doing anything at all in the military. That may reflect not just Britain's smaller army but also its recruiting. Almost a tenth of the British Army is composed of soldiers from 57 different countries, with some 3,500 Nepalese Ghurkas, 2,000 Fijians and 975 Jamaicans filling the ranks.

Britain's steady withdrawal from Iraq has also played a role in dampening active dissent. Why march to bring the boys home when Gordon Brown, the prime minister, is already expected to cut the forces in the field?

Fewer Britons oppose the involvement in Afghanistan, where British forces have more than doubled in the

past 18 months, to 7,700, and casualties are also rising. This may be because a plurality (at least of those who talk to pollsters) think Afghanistan can still be won, compared with an outright majority who think the effort is failing in Iraq. Public support, it seems, hinges less on whether soldiers are dying than on whether they are winning.

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Motorcycle gangs

Thrills and kills

Aug 16th 2007
From The Economist print edition

Racing, not feuding, is what British motorcycling is really about

CHEQUERED flags flutter above the Ace Cafe on London's old North Circular Road, welcoming motorcycle pilgrims from around the world. One devotee recently rode there all the way from Pakistan on a 1940s Triumph to savour a drink in one of the holy sites of rock, roll and speed. In the 1950s young men would gather at the café to compare their machines and challenge each other to “record races”, zooming off to a landmark and back before the jukebox had finished playing a chosen song. The Ton-Up boys, as they were known, were named after the “ton” they tried to achieve—100mph.

Those were dangerous times. But the murder of a rider this week, shot dead on his Harley-Davidson as he returned from the “Bulldog Bash”, an annual bikers' rally, has drawn attention to another kind of danger associated with motorcycles. The victim, Gerard Tobin, was a member of the Hells Angels, a biker gang that has a difficult relationship with the law (and with apostrophes). Police think he may have been killed by a rival gang—or a faction of his own. Six years ago another man was shot in similar circumstances following the rally, but lived to tell the tale.

Hells Angels, like the Harleys they ride, are American imports. Both have been influential: sales of chrome-plated “custom” bikes have doubled in the past ten years in Britain, and the public's idea of a biker is still modelled on the Angels: big, patch-wearing and fond of beer.

At the Ace Cafe, not much of this holds true. There is a certain amount of chrome in the car park, but the café's manager, Mark Wilsmore, says the most popular bikes these days are the high-powered sports variety. “People always picture us like this,” he says, sitting back and holding out his arms as if holding big “Easy Rider”-style handlebars. “But British motorcycling is really more about *this*”—and he leans forward like a racer.

Industry figures support his view: “supersport” motorcycles outsold every other style last year, shifting twice as fast as custom bikes. “Born-again riders” rediscovering their old hobby after paying off their mortgage (or getting divorced) have helped this trend, as have relaxations in the law governing access to big-engined bikes. But even the youngsters at the Ace's monthly “Twist 'n' Go” scooter-themed night seem more interested in speed than shiny bumpers: most are likelier to visit Silverstone or Brands Hatch than go to a rally like the Bulldog Bash, Mr Wilsmore reckons.

One side-effect of the interest in speed thrills is an indifference to alcohol. Cruising along Route 66 might be easy enough after a beer, but racing doesn't go so well with drink. “We could have 5,000 people here, and the till roll will show three Jack Daniel's and half a dozen beers,” Mr Wilsmore says. Real bikers, it seems, drink tea.

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Summer internships

Internal affairs

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From The Economist print edition

The law—and self-interest—are driving up pay

MONICA LEWINSKY was the first intern that many Britons had ever heard of. When news broke in 1998 of her fling with the American president, many were unsure quite what (apart from the obvious) her job had entailed. One British newspaper described her as a “work-experience trainee”. Internships, which had long helped Washington to run smoothly, were then unusual in Britain.

Nine summers on, British offices are buzzing with eager young people in new suits. London's big banks are employing more than 100 undergraduate interns each, paying them upwards of £600 a week in return for shifts ending well past midnight. The intern circuit has extended to management consultancies, accountants and engineering firms, whose schemes also handsomely out-pay burger-flipping. Last week Weil, Gotshal & Manges, a legal practice, announced plans to fly its interns to New York.

The boom has been driven by firms competing to collar the cleverest students. Five years ago private-equity firms and hedge funds began poaching the bright sparks who used to go into banking, says Alison Bird, a careers adviser at Oxford University. “The question banks always ask us now is, 'How can we reach them?',” she says. A flashy internship is seen as the best advertisement possible.

Yet not all placements are so appealing. Paul Sellers of the Trades Union Congress worries that “glamorous” industries such as television, film and public relations are using internships as an excuse for ripping students off. “People are queuing up to join. If you're a bit unscrupulous you can make them do loads of work for free, without even teaching them much,” he says. Mark Runacus of Hicklin Slade, a marketing firm, says some advertising companies rely heavily on free labour. “Rumour has it some big agencies couldn't survive the peaks and troughs of work without them,” he says. Artists and copywriters now slog for months unpaid. “I was a working-class kid. There's no way I'd have been able to afford to do this,” Mr Runacus says.

Although the “intern” label is sometimes attached to jobs in order to pay less than the minimum wage (which guarantees £5.35 per hour, or £4.45 for those aged 18 to 21), there is no such exception in law unless the stint is part of an educational course (which most are not). Yet the situation has gone unchallenged, partly because it is so widespread. MPs are unlikely to press for better enforcement, given that they themselves have been enthusiastic users of unpaid researchers. Many newspapers are in no position to kick up a fuss.

Things may be changing. Following the complaint of a young and unpaid Labour Party cameraman, MPs have been sent guidelines on how to treat their eager young helpers. In February the government advised television companies that although unpaid “shadowing” was fine, any student doing something useful should be paid the minimum wage.

Careers departments are also cracking down. Oxford University has begun calling companies that advertise unpaid internships to ask them to justify themselves. The University of London has just banned such adverts altogether. So has Imperial College—though its head of careers, Elspeth Farrar, suspects the same opportunities may resurface, renamed “voluntary work” or “work shadowing”.

Strong-arming tactics may prove unnecessary. For the first time, this year IPA, an advertising-industry body, is running a “summer-school” internship for nine students, who are getting £1,000 each plus expenses. Mr Runacus, who helped set up the scheme, says paying people properly is only fair. But it also allows companies to give candidates an extended once-over. Some banks now hire more than two-thirds of their new analysts straight from their internship schemes. How long before other industries catch up?

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Scottish independence

A debatable revolution

Aug 16th 2007 | EDINBURGH
From The Economist print edition

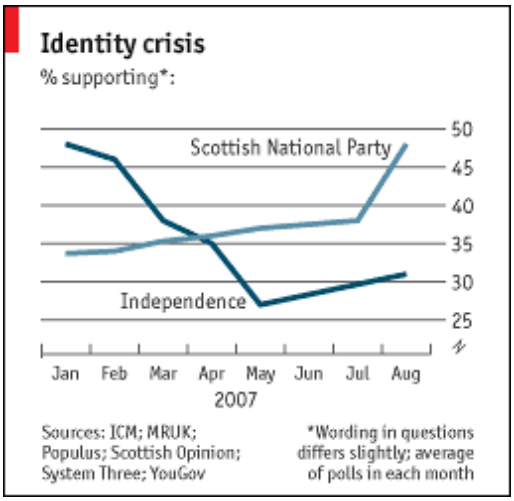
A dull white paper does the political business

Get article background

REVOLUTIONS are usually forged with blood and sacrifice. Not so the break-up of Britain that Alex Salmond hopes to have begun on August 14th. With cannon fire and cheering crowds notably absent, Scotland's nationalist first minister merely remarked that it was a “big day”, as he published a white paper outlining what needs to be done to make Scotland an independent country.

Indeed, the document is disappointingly dull. It consists mainly of a long list of the powers that the devolved Scottish Parliament could usefully acquire, plus a draft bill to make possible a referendum that Mr Salmond thinks might be staged in around 2010. Analysis and argument are missing; on the economic benefits that independence might bring, for example, the paper says only that it is a “matter of debate”.

The reason for the sobriety is two-fold. First, Mr Salmond has at most only 50 votes for independence in the 129-seat Scottish Parliament. Second, although the popularity of the Scottish National Party (SNP) has soared to unprecedented levels (thanks to a lavish helping of spending give-aways), popular backing for independence itself—the SNP's central message in the May elections—has fallen to about a third (see chart).



This is perhaps because the voters who propelled the SNP to power in May were more concerned with ousting a tired Labour/Liberal Democrat ruling coalition than with overthrowing the constitution. “The SNP didn't get into power because of support for independence,” says James Mitchell of Strathclyde University. “The public are way ahead of commentators in understanding that what is going on is a gradual, complex, multi-faceted process of change, not an event.”

Mr Salmond knows this too. His white paper is longer and stronger on how more power might be devolved from London to Edinburgh within the British union than it is on severing the final links. Briefing the press this week, he seemed much more enthusiastic about maximising devolution than about gaining ultimate sovereignty.

He may be politically prudent to do so. On August 13th the Scottish Labour, Conservative and Liberal Democrat leaders united to issue a statement repudiating independence but indicating that they might be prepared to work together to enhance the Scottish Parliament's responsibilities. “The tectonic plates of Scottish politics have shifted,” Mr Salmond exulted.

As if to underline the point, Jack McConnell, the Scottish Labour leader, resigned from that post on August 15th, having argued unsuccessfully at the hustings in May that no big constitutional change was needed. But his likely successor, Wendy Alexander, who is generally agreed to be the brightest brain on the Scottish Labour benches, has published pamphlets arguing that Scotland should get more power over tax rates than the current limited ability to vary the basic rate of income tax by up to 3p.

The Lib Dems and some Tories agree with this principle, if not on the detail. What unites them with Labour, and separates them all from the SNP, is that they want any package of changes to be drawn up with the help and agreement of the British government—principally that of Gordon Brown, the prime minister.

Mr Salmond intends to start a “national conversation” about his proposals. This may not lead to a national

conversion to the cause of independence. But if it produces a stronger version of devolution, shortening the distance to his eventual goal, it may suit him almost as well.

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Deregulation

Paper, paper everywhere

Aug 16th 2007
From The Economist print edition

Everyone wants to cut red tape. Could the Tories actually do it?

HAVING lost the last two elections promising tax cuts, many Conservatives reckon deregulation is the only economic policy left that can inspire the business lobby without putting off floating voters. So it is not surprising that cutting red tape features in the final report of the party's economic-competitiveness group, due to be published on August 17th. Chaired by John Redwood, a former cabinet minister, the group does not ignore other sources of competitiveness, or lack thereof. Britain's transport infrastructure, for example, is targeted for reform. But the war against red tape has dominated advance previews.

This will surprise those abroad who assume that Britain is a beacon of laissez-faire, with little need for a bonfire of paperwork. The Centre for European Reform, a think-tank that assesses European Union competitiveness, continues to rate Britain as one of its least-regulated members, with Finland and the Netherlands. The latest Global Competitiveness Report, produced by the World Economic Forum, ranks Britain third for “market efficiency”, the closest it has to a measure of regulation.

Nevertheless, the arteries of the British economy are furrier than they were a decade ago. The tax code has doubled in size, and recently overtook India's as the longest in the world. As chancellor, Gordon Brown launched various initiatives against red tape. Most such measures, including setting up the Better Regulation Commission, have disappointed businessmen, who complain that Mr Brown created a good many more regulations than he abolished. Mr Redwood is right that the stakes are high: with its infrastructure and productivity unimpressive by rich-world standards, Britain is left with flexible markets as a large part of its competitive advantage. Deloitte, an auditing firm, reckons it will slip from sixth to twelfth in its world-competitiveness league by 2010, in part due to regulation.

Some of Mr Redwood's ideas are already Tory policy, such as abolishing home-information packs in property deals and issuing fewer targets to local government. These, however, would dent the overall burden of regulation only slightly. Other ideas are more radical, but also harder to achieve. It is not obvious how Britain can excuse itself from EU labour laws, such as the Social Chapter and the Working-Time Directive, without compromising the terms of its membership. Simplification of the tax code makes sense and is often urged, but detail is essential.

Vince Cable, the Liberal Democrats' deputy leader, points out that long-term cuts in red tape are achieved not by a flurry of “quick wins” but by process reforms, such as requiring independent assessment of each new rule's impact and giving regulations an expiry date. Mr Redwood entertains these ideas—he is expected to recommend sunset clauses and more parliamentary time for debating regulations—but some experts question their effectiveness. Martin Lodge of the London School of Economics argues that when a regulation is about to expire, those with a vested interest in its survival mobilise to preserve it. This, he suggests, is why the idea of sunset clauses is kicked around every few years but never implemented.

How much of Mr Redwood's report the Tories adopt will rest partly on how far it compromises the rest of their agenda. Labour and the trade unions have noted the tension between relaxing laws that limit working hours and the professed concern of David Cameron, the Conservative Party leader, with people's work-life balance. Yet, as the Tories insist, regulation often hits the weakest hardest. Small firms suffer more than large corporations that can afford compliance departments. Perks and protection for existing workers may make firms reluctant to hire new ones. Mr Brown plans to brandish the report as proof that the Tories are lurching to the right. If they make these points effectively, he will find it harder than usual.

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Bagehot

The perils of privacy

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Illustration by Steve O'Brien

Britain's wayward yoof is an old problem, but a problem all the same

ONE evening, when Bagehot was at university, a student who lived next door to him fell badly ill. An ambulance was called, but its route was blocked by a pile of clothes and a gaggle of drunk, naked young men. They were members of a drinking society (roughly analogous to American fraternities). The boozy nudity at precisely this spot, they explained, refusing to budge, was an awfully important initiation rite.

This incident came to mind last month when something not dissimilar happened near Wigan, in northern England. A group of youths obstructed an ambulance and harassed the paramedics in it, whose patient died. That little act of thuggery was scarcely noticed amid the ongoing run of murders by British youngsters, by knife and sometimes gun. Most of the victims have been young too: 18 people aged 18 or under have been killed in London this year, stabbed on the street or shot in nightclubs—not many by Los Angeles standards, perhaps, but troubling by Britain's. Not all the victims have been teenagers: a father in Warrington was beaten to death outside his home last week after remonstrating with vandals. “No street is safe any more from marauding hooligans,” lamented the *Sun*, which recently fulminated about the yobs who urinated in drinking-water supplies delivered to flood-stricken western England.

Are British delinquents really more depraved, and more numerous, than they used to be, or than other countries' are? That university prank—as well as confirming that the posh and plebeian classes can be oddly alike—suggests that there is little new under the sun, even if the *Sun* says there is. Hysteria over degenerate children was even more intense in 1993, when two ten-year-olds murdered a toddler in Liverpool. From punks and skinheads, through the gangs that prowled the post-war London rubble and beyond, “yoof” has always been a concern, and always getting worse. “I would there were no age between sixteen and three-and-twenty,” says a Shakespearean character, “for there is nothing in the between but getting wenches with child, wronging the ancientry, stealing, fighting.” It is true that more teenage British wenches are got with child than other European ones, and that British teenagers are unusually prone to taking drugs, fighting, venereal disease and boozing: a senior policeman called this week for tighter rules on alcohol. But few who drink or smoke pot graduate to knife crime. Many do none of these things; most are better-off and better-educated than ever.

Not much has changed—and don't generalise: those are the relaxed arguments of some sociologists, criminologists and other yoof-ologists. But an old problem still counts as a problem; that Britons have always worried about yoof doesn't mean they are wrong to do so now. And conversations with teachers, youth workers and yoof itself suggest that in some ways the plight and behaviour of teenagers have indeed deteriorated.

Hard evidence is difficult to come by, but more British teenagers seem to be carrying knives, intended to protect but liable to endanger. More assaults than previously seem to be provoked by imagined “disrespect”; afterwards, a teenage *omerta* often confounds the police. Murder is still overwhelmingly a male offence, but girls seem to be committing more violent crime too. Urban gangs are pursuing rivalries and vendettas against groups from other neighbourhoods, separated by boundaries that are invisible to oblivious adults. “Happy-slapping”, whereby assailants film their attacks for their later amusement, has been an unanticipated consequence of putting cameras on mobile phones.

As in America, the worst problems are often concentrated in specific communities. But they have wider costs, because adults can't tell the sociopaths from the bored loiterers. British adults, research suggests, are less likely to intervene than other Europeans if they see youngsters up to no good, with the result that parks and squares are turned over to adolescent rule.

Only relate, relatives

Naturally, the -ologists have lots of explanations, and the government lots of remedies. Some see youthful misbehaviour as the cost of progress—for example, as a by-product of affluence, which in combination with inequality has produced a rump of poor and resentful children. Another mostly benign trend, in Britain as elsewhere, is the elongation of adolescence, as many youngsters spend longer in education, unmarried and at home; the dark corollary of that, for some of the stubbornly large number of British kids who leave school with few or no qualifications, and who no longer go straight into a factory or trade, is a risky limbo period before they settle down. Other explanations finger parents, for getting divorced more than they used to, for absconding or for working long hours, all of which Britons are unusually inclined to do.

Yet it seems to Bagehot that there is something else peculiar to British families, at least among Europeans—an oddity that is especially salient at this time of year. Visitors to piazzas or plazas are likely to see several generations of continental families happily talking, eating and even dancing together. British children, by contrast, spend relatively little time with their parents, and not only because the parents aren't around: many see fraternising with them in public as a fate worse than a mobile phone without a camera. Meanwhile, as that senior policeman complained this week, many British parents, whether there are one or two of them, seem indifferent to their children's antics, or incurious about them. Since the clubs and churches that once thrust them together have withered, unrelated youngsters and older people don't talk much either.

The British are an emotionally unforthcoming lot in general; perhaps this intergenerational chasm should be seen as just an extreme form of the privacy and reserve that mark many British relationships. But it is a dangerous one.

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The Arctic

Drawing lines in melting ice

Aug 16th 2007 | COPENHAGEN, MOSCOW AND OTTAWA
From The Economist print edition

Bryan and Cherry Alexander

Despite the ungainly scramble for a slice of the Arctic's tantalising riches, no nation can master the region alone

THE Arctic has been a fashionable destination this summer. A team of Danish researchers, heading northwards on a Swedish ice-breaker, has just set sail from Norway. Meanwhile an American Coast Guard cutter, with a crew of scientists, has embarked on another expedition to map a giant swathe of ocean floor.

That was only this week's polar news. It came hard on the heels of a storming visit to Resolute Bay on Canada's northern extreme by Stephen Harper, the prime minister. He announced a new deep-water port and military training base, declaring that “the first principle of Arctic sovereignty [is] use it or lose it.” Still more eye-catching—even if some of the footage shown on Moscow television really came from the film “Titanic”—was a Kremlin-backed voyage, which led to the planting, by a minisub, of a titanium Russian tricolour on the seabed.

Like any celebrity who is caught following the crowd, all the Arctic travellers insisted that their plans had been made ages ago and that the coincidence of so many polar expeditions was purely haphazard. Don't believe a word of it. What looks like an unseemly dash to claim great chunks of the Arctic—the sea, the ice, and whatever lies underneath—is precisely that. But why is it happening now? Clearly, the boom in energy and commodity prices has changed the economics of difficult searches for oil, gas and minerals. The steady shrinkage of polar ice-caps, as a result of global warming, is making previously inaccessible deposits much easier to get at—and helping to open some formerly icebound shipping lanes.

For all the historic resonance of Russia's flag-planting foray, the current dash to the Arctic is not—or at any rate, not yet—a simple race to create “facts on the ground” which can then be consolidated, and if necessary defended, by military power. It has more to do with the establishment of legal arguments, which have to be shored up by scientific data.

All the parties with a claim to a slice of the Arctic are intensely conscious of the terms of the 1982 United Nations Convention on the Law of the Sea, which is supposed to regulate almost all human uses of the high seas, from fishing to mining. Under the convention, governments can lay claim to an economic zone up to 200 nautical miles (370km) from their coast—or further, if they can prove that the area in question is an extension of their own continental shelf. Precisely such a claim is made by Russia with respect to the Lomonosov Ridge, which stretches from the Russian coast to Greenland. And this week's Scandinavian expedition may lend support to a claim by Denmark that the ridge is connected to Greenland, which is under Danish sovereignty. “There are things suggesting that Denmark could be given the North Pole,” as the country's science minister, Helge Sander, eagerly puts it. The Canadians, for their part, say the ridge could be an extension of their own Ellesmere Island.

Such a cacophony of arguments could keep lawyers and geographers busy for decades. So why the hurry? Because any country that wants to make a claim under the Law of the Sea must do so within a decade of ratifying it. Russia's deadline is 2009. Canada must set out its case by 2013, and Denmark by 2014.

As for the United States, it respects the convention in practice but has not ratified it, because some senators fear a loss of American sovereignty. The bodies created by the convention—the International Seabed Authority, and International Tribunal for the Law of the Sea—worry conservative American groups like the Heritage Foundation which fear global bureaucracies.

These objections may soon be overcome: the Bush administration, along with moderate Republican senators like Richard Lugar now want to sign up to the convention and start making America's case.

But between setting out a claim under the Law of the Sea and enjoying the fruits of ownership there is a long route to be trodden. An agency called the Commission on the Limits of the Continental Shelf decides on the merits of the case, but it has no powers of enforcement. A ruling may lead to counter-claims by other countries. In the end, bilateral talks may be needed; they can last for decades. There have been calls, over the years, for a more sensible way of dividing up the Arctic—but as the prizes look more tantalising, setting rules for the game will probably get even harder. For now, the only inter-governmental body with a say over the region is the Arctic Council: its mandate is narrowly environmental. “It has been purposely hobbled,” says Rob Huebert, a polar specialist at Canada's Calgary University.

People who love the Arctic for its beauty, not its riches, look enviously at Antarctica, which was carefully parcelled out by a treaty regime designed to stop the cold war spreading south. “Countries shouldn't be allowed to fight over borders here,” insists Jake Moreland, the recent British winner of a race to the North Pole.

If governments never got round to parcelling out the Arctic, that was partly because harsh conditions seemed to preclude most economic activity. Now, of course, the calculation has changed, though some of the present talk about an Arctic El Dorado may be exaggerated.

An oft-quoted figure—that the region contains 25% of the world's undiscovered oil and gas—is generally attributed to America's Geological Survey. Don Gautier, who works for that agency, retorts that it has never done a systematic study of the Arctic, or put a figure on its energy riches. But the United States and other Arctic nations are doing a survey now, and a clearer picture may soon emerge.

At least in the short term, Mr Gautier says, government activity in the Arctic has more to do with transport routes than with under-sea riches. But for shippers no less than for oilmen and miners, expectations of quick gains may be overdone.

Take the Northwest Passage, to which the newly proclaimed Canadian port of Nanisivik marks the eastern entrance. At the moment, this route through the Canadian archipelago is navigable at best for a brief summer spell. (Sovereignty over the passage is one of the Arctic's many unresolved issues: Canada claims it, but the United States says the waters are international.) In theory, a complete opening of the Northwest Passage can shave 2,500 miles off a journey from Europe to Asia. But Lawson Brigham of the United States Arctic Research Commission, based in Alaska, is not convinced the financial gains will be dramatic. “Has anybody done the economics?” the former coastguard captain asks. In fact, he and fellow researchers from the Arctic Council are doing some sums at the moment; they will complete their assessment of global warming's impact on shipping next year.

Despite the appearance of a free-for-all, governments and scientists still co-operate over the Arctic; often there is no choice. In the Danish expedition that set sail this week, the Swedish ice-breaker is being led northwards by a larger Russian one, the *50 Years of Victory.* And, despite a Canadian-Danish tiff over tiny Hans Island, the Canadians will help the Danes by providing some data on the ridge.

Having dropped (back in 1990) a plan to build the world's biggest ice-breaker, the Canadians may also have to seek Russian help next time they need to carve out a path to the North Pole: even the patrol boats ordered up by Mr Harper this month won't match Russia's leviathans.

And despite the general surge of Slavic pride, Moscow's recent Arctic foray was far from being an all-Russian affair. One member of the crew was a Swede, Fredrik Paulsen, who paid $3m for his ticket; another an Australian businessman, Michael McDowell. “Russia's role in the expedition was to provide transport for rich foreign tourists,” grumbles Lev Savatyugin of the Arctic and Antarctic Research Institute. He is also sceptical of the expedition's scientific value, saying that gathering gravel from the surface of the seabed proved little about long-term geological movements; you need to dig deeper, and other Russians have already been doing that.

For the time being, the fact that no nation can conquer the Arctic on its own is probably a source of relief. At a moment when nationalistic claims and counter-claims are resounding over the ice-floes, the region's intractability still forces its would-be conquerors to rub along.

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Inuit politics

Save our spears

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What the sentimentalists don't get

Rex

BACK in 1989, when Soviet reforms enabled Russia's Arctic people to confer with counterparts from other states, there was euphoria among the Inuit, once known as the Eskimos.

Since then, the Inuit Circumpolar Council—grouping indigenous people from Greenland, Canada, Alaska and Russia—has become a vigorous lobby. Among its causes: resistance to moves by governments or environmentalists to limit the hunting of seals and polar bears. The Inuit say that with their ancient knowledge, they are the best judges of how much to hunt. As one of their leaders puts it, sentimentalists from the south are driven by an “emotional and irrational” attachment to animals rather than any understanding of conservation or local society.

The group's line on energy development is that it should be “safe, equitable and environmentally friendly”—and that it should not divide the Inuit, who began conferring in the 1970s because they thought oil and gas firms were ignoring the first owners of the Arctic.

Aqqaluk Lynge, a poet-politician (above) who may be the best known of Greenland's Inuit, recently broadened his campaign against climate change by joining the opposition to the expansion of Britain's Stansted airport. “Stop interfering with my climate, and I won't interfere with your airports,” he assured Britons, while defying green correctness with his fine sealskin waistcoat.

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Japanese business

Gaijin at the gates

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Illustration by Claudio Munoz

Japan is courting foreign investors, not for their money but for their ideas

SEIYU, a Japanese discount retailer, this week forecast its sixth straight annual loss. But its chief executive did not bow in contrition as other Japanese bosses might have. Instead, Ed Kolodzieski gushed about the firm's bright future, his southern American twang a testament to his former role as an executive at Wal-Mart, which owns a majority of the Japanese firm. Despite Seiyu's terrible performance, its American parent is pouring in money to modernise its stores.

That is just how Japan wants it. The government is trying hard to attract foreign direct investment (FDI). It has revamped the commercial code, made it easier for foreign firms to buy Japanese ones and set up a whole bureaucracy to win over hesitant investors. Yet this enthusiasm underscores an oddity: why should a country that has an excess of capital seek out foreign money?

The answer is not for the cash, but for the people and ideas that come with it. Japan hopes foreigners can reform companies, introduce competition and shake up old industry structures in ways that domestic firms cannot. “It is important that we have more new players in the Japanese economy, with new ideas and new business models,” says Nobuyuki Nagashima of JETRO, a government agency that used to promote Japanese exports, but which now has an additional mandate to attract foreign investment.

The notion that *gaiatsu*, or “foreign pressure”, can spur reform has a long history in Japan. In 1853 the “black ships” of America's Commodore Perry forced the Japanese market open at gunpoint, helping to unwind centuries-old feudal traditions. More recently, if less flamboyantly, foreign firms have disrupted the Japanese market by creating competition.

For example, Renault's Carlos Ghosn restored a near-bankrupt Nissan to health by drastically cutting suppliers and staff (though it has faltered lately). The arrival of Starbucks forced other coffee-shop chains to improve. Foreign insurers unleashed a bevy of new products that have been aped by domestic rivals. And foreign private-equity funds have fixed and flipped many foundering firms.

But Japan's embrace of foreign investment has been less successful than these examples suggest. Although Japan's inward FDI doubled between 2000 and 2005, it still amounted to only 2.4% of national output, far less than in other big economies. In America the comparable figure is 15%, and in Germany, France and Britain it is between 30% and 40%. This means that foreign firms' share of the economy is far smaller than in other countries (see chart).

Japan lags so far behind for both economic and cultural reasons. Consumer spending is sluggish, wages and prices are falling and the population is shrinking. “Japan is a somewhat saturated market already—the incentive for foreign investment is not that high,” explains Frances Cheung, an economist at Standard Chartered, an investment bank. Nor can Japan compete as a regional export hub with the likes of Singapore and Shanghai. The tax code makes life difficult for foreign firms and red tape abounds. As a result, Japan is losing the race to attract global capital, says Seiji Adachi of Deutsche Bank.

Cultural factors are an even bigger hurdle. Many companies resist foreign takeovers for fear that the new owners will restructure too harshly, slashing jobs and spurning suppliers of long standing. In fact, restructuring is hard, which makes takeovers less attractive. Foreign investors say they struggle to find managerial talent. People tend to work their way up the hierarchy in a single firm for their whole careers, leaving few managers in the labour market. All told, foreign companies often find that investing in Japan involves too much effort for too little profit.

Yet garnering FDI is critical for Japan's future. In manufacturing, labour productivity at the Japanese affiliates of foreign firms is as much as 60% higher than it is at domestic firms; in services firms it is 80% higher, according to the Organisation for Economic Co-operation and Development. Thanks to its declining population, Japan will have to increase productivity dramatically to maintain living standards. Yet productivity is lower than in many other countries and by some measures is falling further behind.

Furthermore, acquisitions by foreign buyers have tended to increase the overall value of Japanese firms. Three years after an international takeover, profits have increased by 35% on average, according to ABeam Consulting, and the overall value of firms acquired by foreigners has increased nearly twice as much as those bought by domestic competitors.

Foreign firms can bring competition to Japan where local ones might not because they do not feel bound by existing approaches or business relationships, notes Nicholas Benes of JTP, a firm that advises on mergers and acquisitions. They are also often the most efficient in their industries. Steven Vogel of the University of California at Berkeley has found that foreign-owned firms are more likely to restructure than Japanese ones. And the investment reaches economically stagnant corners of the countryside, not just the relatively prosperous big cities.

Heang Chhor, the head of the Tokyo office of McKinsey, a consultancy, believes there is good reason to invest: trillions of yen will be spent over the next decade by the elderly on everything from holidays to health care. In 2025 the country will still account for at least 10% of global output.

This is what attracted Wal-Mart in 2002, when it bought its stake in Seiyu. So far, it has had scant success: Seiyu's share price has fallen by three-quarters since Wal-Mart invested, thanks to the same inefficiencies that afflict most Japanese retailers. So the American firm is trying to change the very way the Japanese business operates, particularly by introducing Wal-Mart's advanced IT system, called RetailLink, which analyses store performance and customer trends.

“Seiyu is bogged down in old customs that are wasteful,” explained Toru Noda, the company's chief operating officer, when it revealed more losses this week. Wal-Mart brings proven skills in managing big supermarkets, he said. “It is what we would like to learn to do.”

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Garments in Bangladesh

Knitting pretty

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The clothing business is flourishing despite Chinese competition

Get article background

THE garment trade in Bangladesh, as in many poor countries, sprang up solely because of preferential access to important markets such as the European Union (EU) and America. So when the rules governing exports to rich countries were changed at the beginning of 2005, Bangladeshis feared huge job losses. Once the quotas that had guaranteed a share of the market to all exporting countries were abolished, they assumed, China would hoover up all the jobs in the industry.

Yet Bangladesh's garment exports are booming. Last year, it sent clothes worth $8.9 billion to rich countries. Revenues from the garment trade account for about 80% of all exports and are double the remittances sent home by Bangladeshis working overseas—the economy's other pillar. The country has made use of its labour, its only abundant resource. Wages are lower than in China, India, Cambodia or Vietnam, its main competitors. About 2m people—90% of them women—work in the rag trade, and another 15m jobs depend indirectly on making clothes, through firms that produce thread, buttons and textiles. On today's trends, Bangladesh's garment exports will soon overtake those of its giant neighbour, India.

Cheap labour, along with a reluctance among buyers to rely on China for all their purchases, appears to have won the Bangladeshi industry a reprieve. But the recent growth in exports to its two biggest markets, the EU and America, has occurred since the pair imposed transitionary restrictions on Chinese exports, which end next year. Meanwhile, in Canada, the only big market that places no restrictions on China, Bangladesh has lost market share.

To reduce the risk of a similar setback in America, Bangladesh has enlisted Muhammad Yunus, its Nobel prize-winning micro-credit pioneer, to lobby for duty-free access, “to put Bangladesh on par with other least developed countries”. But bosses fear that the stricter labour standards that would accompany such a concession might outweigh the benefits. Most garment workers are not unionised, although big protests did force the government to announce a near doubling of the minimum wage to Tk1662 ($25) a month last year—the first increase since 1994.

Bangladesh is most competitive in knitwear, which has grown from 15% of its garment exports in the early 1990s to over half this year. The secret is the inputs, some three-quarters of which are made locally. That saves firms the transport and storage costs, import duties and long lead-times that come with the imported “woven” fabric used to make shirts and trousers. It also entitles them to duty-free access to the European Union. “In the long-run, the woven garment sector will probably leave Bangladesh”, says Mohammed Quasem, a knitwear tycoon whose latest factory is about to start up in the town of Gazipur with 10,000 workers.

In the short run, garment-makers of all stripes are simply trying to survive an indiscriminate anti-corruption drive launched by Bangladesh's recently installed military regime—a disadvantage for which neither low wages nor trade preferences can compensate.

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Italian champions (1)

Spectacular results...

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Italian firms dominate the world of eyewear

BY ITALIAN standards, the valleys of the mountainous province of Belluno are not particularly sunny. But on cloudless days, the locals are well-prepared. A cluster of family-controlled firms in the area, such as Safilo, Marcolin, Marchon, and De Rigo, produce the vast majority of the world's sunglasses. Although many Italian firms are struggling to cope with cheap competition from Asia, compounded by the strength of the euro, these eyewear-makers are doing well. The biggest of them, Luxottica, had sales of €4.7 billion ($5.9 billion) last year.

“Ten years ago, sunglasses were a functional device,” says Andrea Guerra, chief executive of Luxottica, which is more than four times bigger than its nearest rival, Safilo. Nowadays, fashion takes precedence. Sunglasses have coloured lenses, oddly shaped frames, and all manner of adornment, including loud logos in silver and gold, clusters of diamonds, and fluffy fur lining. Prices—and margins—have risen in proportion to the opulence of the accoutrements.

Italian eyewear-makers have taken advantage of this trend both by marketing their own brands and by making sunglasses under licence for Italian and French luxury-goods firms. Luxottica has won the most lucrative contracts in recent years, including licences from Burberry, a British fashion house, and Polo Ralph Lauren, an American one that it enticed away from Safilo. The firm also scooped up a contract with Tiffany, an American jeweller, which is launching a line of sunglasses next year.

But Mr Guerra attributes Luxottica's success both to the strength of its in-house brands, and to its control of the retailers where they are sold. Defying sceptics, Luxottica bought LensCrafters, America's biggest optical retailer, in 1995. This was followed by the acquisition of Sunglass Hut, the world's leading retailer of sunglasses, and Cole National, another big outlet. Brands it owns, such as Ray-Ban, acquired in 1999, are the backbone of the business, accounting for 43% of wholesale sales according to a report by Lehman Brothers, an investment bank. In June Luxottica announced the purchase of another portfolio of brands with the $2.1 billion takeover of Oakley, a California-based maker of sunglasses.

Luxottica is still finalising the acquisition of Oakley, but it is already about to make its next foray into America, which accounts for some 85% of its retail sales. Next month it plans to open a flagship store for ILORI, its new retail chain for ultra-fashionable (meaning very expensive) shades in SoHo, a hip part of Manhattan. Another shop, on Rodeo Drive in Los Angeles, is also nearing completion. Over the next two to three years the firm plans to open some 150 ILORI shops in America.

Luxottica thinks it can persuade Americans to spend more on sunglasses. Whereas 90% of pairs sold in Europe cost more than $30, only 10% of those bought in America do. ILORI is aiming at the most extravagant customers. Prices will start at $250 and rise to as much as $10,000. Michael Hansen, boss of ILORI, is confident that clients will be keen on the ILORI “experience” in the SoHo shop, designed by Craig Nealy, an architect who has also built stores for Louis Vuitton and Vera Wang. They will be able to relax in a “VIP lounge” and model prospective purchases on a special runway. Sunglasses are the third-fastest growing category in luxury goods after shoes and handbags, says Mr Hansen. Newly rich Russians, among others, are buying such items at hitherto unthinkable prices. Hermès makes a $140,000 handbag and Montblanc sells a pen for $700,000. So, asks Mr Hansen, why not spend $10,000 on a pair of sunglasses, which will be just as visible to gawping bystanders?

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Italian champions (2)

...and a sweet success

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A maker of ice-cream churns takes a rocky road to world domination

WHETHER cone or cup, soft-serve or *gelato*, the odds are good that the ice-creams bought by sweltering sight-seers and beach-goers across the northern hemisphere this summer came from machines made by Carpigiani, a private Italian firm. In more than 100 countries, the firm's distinctive blue and white emblem has come to stand for the very Italian art of making ice-cream. Several large franchise chains such as Cold Stone, which has over 1,400 stores in America and East Asia and expects a further 70 to open this year, depend on Carpigiani's machines. So do fast-food chains like Pizza Hut and McDonald's. The firm has won around half of the global market for ice-cream makers, according to Gino Cocchi, its managing director.

No wonder, then, that Carpigiani is now making money by the scoopful: operating profits exceeded 20% of its revenues of €130 million ($163m) last year. This dominance might not seem surprising. After all, Italian firms make a lot of the machines used to make other things, for which the country is famous, such as pasta and espresso.

But Carpigiani's success has not always been assured. It stagnated for much of the decade after the death in 1982 of Poerio Carpigiani, a smart marketing man and one of two brothers behind the firm. (The other, Bruto, who designed their first machine, died in 1945, one year before the company was founded.) Complacency had set in. Quality fell, complaints rose and Carpigiani's share of world sales slipped from 25% in 1980 to 15% in 1990.

Mr Cocchi, who was brought in from a sister firm that year, resorted to the sort of overhaul that many struggling Italian companies now face. “We had to relearn the importance of customer-service, of quality and of being ahead of competitors with new products,” he says. He cut costs and simplified the Carpigiani's structure by cutting its 1,000-strong workforce by half. He scrapped television advertising, always an extravagance for a machinery manufacturer. Carpigiani also resorted to outsourcing. Its four factories (two in Italy, one in Spain and one in America), which produced about 40,000 machines last year, are essentially assembly lines, as few parts are made in-house anymore.

The introduction of a system for quality control also helped get Carpigiani back on track. It was the first firm in the business to win ISO9001 certification. A renewed emphasis on research and development was especially important, since poor materials caused many of the firm's problems. Carpigiani's technical department had 10 employees in 1990 when the payroll at its factory and headquarters in Anzola Emilia was 300; it now has 50 out of a payroll of 250. Its Gelato University teaches the nuances of ice-cream making, and collaboration with traditional universities reinforces its internal research. The university in nearby Bologna, for example, is helping it to develop special steels, composites and plastics.

All this helps Carpigiani meet stringent regulations for machines that make food in countries such as America. The firm generates about one-third of its income there, with its 85% share of the American market for machines that make posh Italian ice-cream and 30% for machines that make soft ice-cream. Hygiene is fundamental. Machines that minimise intervention by human hands by cleaning themselves, for example, are more expensive, but help to ensure that the ice-cream they produce is safe to eat.

Cost-cutting, quality control and technical innovation, in turn, have helped Carpigiani fend off cheaper Chinese rivals, many of which have copied its designs. It is even building a new factory in China, to make machines for the local market. Globalisation may have subjected Carpigiani to stiffer competition, but it is also helping to propagate a taste for genuine Italian ice-cream among China's swelling middle class.

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Technology start-ups

Virtual repeat

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From The Economist print edition

A stockmarket listing recalls heady days

TIME to dust off the dotcom party hats again? Investors drove up shares in VMware, a Silicon Valley software maker, by 76% on its first day of trading on August 14th. That pushed its valuation to $19 billion, and stirred memories of the much-hyped technology initial public offerings (IPOs) of the internet boom. But the chances of Bubble 2.0, let alone Bust 2.0, are mercifully slim.

Technology start-ups are certainly back in vogue. Some have been bought by bigger firms. The acquisition of YouTube, a video-sharing service, by Google for $1.65 billion in shares in 2006 is the best-known example. Venture capitalists are opening their wallets again. In the second quarter of 2007, American VC firms invested nearly $1 billion in information-services companies—an increase of more than 50% compared with the same period last year.

Yet VMware's flotation is a good example of how much has changed. It was able to list on the stockmarket in the teeth of a financial gale only because it actually has a business. The company dominates the market for virtualisation programs, which enable one server to act as many, allowing data centres to run much more efficiently. In the first half of 2007 VMware's revenue and net income doubled, reaching $556m and $75m respectively.

Except for the likes of Facebook, a social-networking site, most start-ups can only dream of reaching such numbers—and will never go public as a result. That matters less to the growth of businesses than it once did, if only because financing needs are lighter. Compared with 1999, developing a new web service is cheap: as low as $100,000 compared with a few million back then, thanks to low-cost hardware, free open-source software, powerful programming tools and new marketing techniques. Some venture capitalists are even wondering whether it is worth bothering with such small investments.

The same reasons that make a bubble unlikely also minimise the risk of a bust. Since the costs of building new technology services are still coming down, people will just keep coming up with new ones—even if they do not make a lot of money and reach only a small audience. Jargon-lovers would doubtless say that the Web 2.0 era has a “long tail”; even if the economics of start-ups do not resemble the dotcom years, the language unfortunately does.

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American airlines

Cash or cookies?

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From The Economist print edition

AP

Their fate hangs in the balance

Rival bidders fight for control of Midwest Airlines

Get article background

IF PERSISTENCE won hearts, AirTran Airways would have long since succeeded in its battle to acquire Midwest Airlines, a mid-sized carrier headquartered in Milwaukee, Wisconsin. AirTran, a low-cost airline based in Florida, first approached Midwest in 2005, attracted by the chance to knit two regional networks into a national one. Midwest, whose on-board service includes leather seats and freshly baked chocolate-chip cookies, rebuffed AirTran, arguing that its prospects would be better if it remained independent and upmarket. “Save the cookie” became Midwest's unlikely rallying cry.

The cookie's prospects seemed assured on August 12th, when Midwest's board rejected a final offer of $15.75 per share from AirTran in favour of a $16-per-share, $396m bid from a consortium led by TPG Capital, a private-equity firm. Unlike AirTran's bid, an acquisition by TPG would allow Midwest to remain a stand-alone airline, retaining both its name and its management team. AirTran itself seemed to concede that the game was up, only to return to the table on August 14th with an improved offer (its fourth so far) of $16.25 per share.

The Florida-based carrier's chances of success have risen along with its offer price. Having recommended TPG's offer in part because of price, Midwest's board of directors will be hard-pressed to turn down a higher bid now. AirTran's revised offer seems to have been partly prompted by a letter to Midwest from Pequot Capital Management, its largest shareholder, arguing that an industry buyer would be in a better position to reap savings.

But the battle is far from over. TPG has a stellar record in aviation: its previous investments include a much-vaunted turnaround of Continental Airlines. It clearly sees opportunity in Midwest, which has a network that is relatively sheltered from the competitive pressures affecting bigger carriers and a regional subsidiary, Midwest Connect, that is performing well. The deal is sufficiently small for the squeeze in credit markets not to constrain TPG's ability to lodge an improved counter-offer.

More important still is the identity of TPG's bid partner, Northwest Airlines, which agreed a code-sharing deal with Midwest earlier in the year and is determined to prevent AirTran from establishing a low-cost hub in Milwaukee, close to its own bases in Minneapolis and Detroit. Mindful of anti-trust concerns, Northwest says that it would be a passive investor in Midwest and would not exercise any management control.

However it turns out, the fight for Midwest underlines the obstacles to consolidation in America's aviation industry, despite its old millstone, excess capacity. Whether it is managers hanging on to their jobs, rivals

protecting their turf, regulators watching for anti-competitive behaviour, or even passengers wanting fresh cookies, deals that make sense in theory are extremely hard to put into practice.

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Face value

China's toxic toymaker

Aug 16th 2007
From The Economist print edition

Alamy

The death of Zhang Shuhong could herald the demise of China's many anonymous subcontractors

Get article background

UNTIL a brief notice appeared in China's state-run *People's Daily* on August 14th announcing that Zhang Shuhong had hanged himself, almost no one had ever heard of him. *The Economist* could not find a picture of him. Even in Foshan, a manufacturing centre in southern China where he owned part of a factory that produced dolls for Mattel, a big American toy-maker, he was an obscure figure.

That is not unusual. There are legions of equally faceless sub-contractors, who are collectively responsible for much of the astonishing growth in Chinese exports. But when Mattel announced a recall of the flawed toys Mr Zhang had made, and especially after he took his own life in response, he became one of China's most famous businessmen—and the embodiment of all the world's misgivings about what comes out of its factories.

The same day that he died, Mattel recalled 436,000 cars daubed with lead-based paint and more than 18m toys containing small magnets which could come loose and be swallowed by children, with dire medical consequences. The recall was Mattel's second of the month. Earlier, the company's Fisher-Price unit had found lead paint on its toys, at least some of which came from Mr Zhang's factory. All of the flawed items were made in China, where 65% of Mattel's products are sourced. The first recall will cost the firm about $30m, and the second might prove more expensive still.

The consequences might have been worse still were it not for the fact that Mattel is hardly the only company to have been caught selling sub-standard Chinese goods of late. Pet food, lorry tyres and toothpaste have all suffered recent product recalls. Nokia has just warned that some of its mobile-phone batteries made in China are prone to overheating, although the factory at fault belonged to Japan's Matsushita.

Some of America's more populist politicians are taking this list as proof that anonymous Chinese subcontractors are not to be trusted, that America needs much more elaborate safeguards against tainted goods and that firms that had outsourced manufacturing to faraway lands would have done better to keep their factories closer to home. Charles Schumer, a tub-thumping senator from New York, has called for the creation of an “import tsar” to police foreign goods.

No doubt many importers will examine their supply chains more carefully, if only for fear that they will be sued by customers who have bought poisonous furniture or explosive mobile telephones, and shunned by

others who hear about such fiascos. This sudden scrutiny will probably bring other scandals to light. Mr Zhang's problems, after all, appear to have stemmed from the contaminated paint he bought from another, as yet unidentified, local industrialist. On the assumption that Mr Zhang was not the local industrialist's only customer, there must be other firms that have not yet disclosed their own shortcomings, or are not yet aware of them.

There are several ironies in this. One is that in China, it is often said that subcontractors making electronics or trainers or toys are not the worst violators when it comes to safety and labour standards. Their products are typically bought by big firms, like Mattel, and the order is large enough for the purchaser to set standards and carry out regular inspections. Smaller foreign firms ordering smaller lots, in luxury goods for example, have a far weaker negotiating position.

Monitoring contract manufacturers from abroad is not easy. Visits to factories are hard to arrange, are often cancelled, and, when they do occur, are sometimes elaborately stage-managed. Reporters are particularly unwelcome, but even customers do not always know what is going on. Mattel, for example, had done business with Mr Zhang for 15 years.

The other irony is that, broadly speaking, quality is improving (something that worries the Japanese). The Chinese authorities are aware of and embarrassed by the recent string of scare stories, and are anxious to revive China's faltering reputation. They have started a high-profile campaign to raise standards and punish slapdash manufacturers.

Getting to know you

What Chinese manufacturing lacks is not so much quality control as accountability. Foreign firms feel obliged to use contractors like Mr Zhang to cope with capricious and corrupt local officials, and the arbitrary justice they mete out. Yet firms like Mr Zhang's are inscrutable and transient, with no brand or reputation to speak of. When Japan was industrialising, ambitious companies did some contract manufacturing, but they also worked hard to build their own brands, as Matsushita did with Panasonic. In South Korea Samsung has prospered by keeping both production and marketing in house. Yet in China, firms like Mr Zhang's eschew brands of their own, and keep a low profile, in order to win contracts from several competing foreign firms.

Until now, this anonymous arrangement suited both the contractors and their clients. It would undermine the brands that Adidas, Puma and Nike have spent so much to promote if their customers knew that a Taiwanese contractor called Yue Yuen produced shoes for all of them in China. Likewise, Hewlett Packard, Dell and Apple do not advertise that they all make use of a firm called Hon Hai. Conversely, it is only by keeping the lowest of low profiles that the likes of Yue Yuen and Hon Hai can sell to several competitors.

But this whole system might founder on the question of quality control. To distinguish themselves from their dodgier rivals, Chinese contractors will have to become better known. In that sense, the suicide of a faceless figure like Mr Zhang, and the furore it has prompted, might prove the death-knell of all China's anonymous industrialists.

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Asia's skills shortage

Capturing talent

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Despite its booming economies and huge numbers of people, Asia is suffering a big shortage of skills. And it is about to get worse

Imaginechina

IT SEEMS odd. In the world's most populous region the biggest problem facing employers is a shortage of people. Asia has more than half the planet's inhabitants and is home to many of the world's fastest-growing economies. But some businesses are being forced to reconsider just how quickly they will be able to grow, because they cannot find enough people with the skills they need.

In a recent survey, 600 chief executives of multinational companies with businesses across Asia said a shortage of qualified staff ranked as their biggest concern in China (see chart 1) and South-East Asia. It was their second-biggest headache in Japan (after cultural differences) and the fourth-biggest in India (after problems with infrastructure, bureaucracy and wage inflation). Across almost every industry and sector it was the same.

Old Asia-hands may find it easy to understand why there is such concern. The region's rapid economic growth has fished out the pool of available talent, they would say. But there is also a failure of education. Recent growth in many parts of Asia has been so great that it has rapidly transformed the type of skills needed by businesses. Schools and universities have been unable to keep up.

Taking wing

This is especially true for professional staff. Airlines are one example. With increasing deregulation, many new carriers are setting up and airlines are offering more services to meet demand. But there is a dreadful shortage of pilots. According to Alteon Training, the commercial-pilot training arm of Boeing, India has fewer than 3,000 pilots today but will need more than 12,000 by 2025. China will need to find an average of 2,200 new pilots a year just to keep up with the growth in air travel, which means it will need more than 40,000 pilots by 2025. In the meantime, with big international airlines training only a few hundred pilots a year, Asian airlines have taken to poaching them, often from each other. Philippine Airlines, for instance,

lost 75 pilots to overseas airlines during the past three years. China has been trying to lure pilots from Brazil, among other places.

Similar problems are bedevilling the legal profession, which is suffering from a grave shortage of lawyers and judges. This can cause a long backlog of cases and other complications in what are sometimes rudimentary legal systems. It can damage the way business is done, for instance in dealing with intellectual property or settling contract disputes. According to the All-China Lawyers Association, the country has only 122,000 lawyers. That is 70,000 fewer than California where the population is only 37m (against China's 1.3 billion). Many business people might argue that California is overlawyered, but there are parts of China without any lawyers at all.

A report presented at the Chinese Party Congress in March by the Jiu San Society, a group of progressive Chinese intellectuals, stressed the shortage of doctors. There are only 4,000 general practitioners in China. But if the government is to achieve its ambition of establishing community hospitals for the country's 500m urban residents, it will need 160,000 doctors to staff them. There is a huge shortage of nursing staff as well.

The scarcity of accountants is already having a regional impact. In order to list their shares in Hong Kong or Shanghai, many Chinese companies are busy preparing internationally acceptable accounts and statutory reports. With the country's own bean-counters trained in Communist-era systems—which never paid heed to capitalist ideas like profits or assets—accountants are being lured to the mainland from Hong Kong and the rest of the region. A senior manager at one of the big audit firms recently arrived in Hong Kong after a long stint in Russia, took one look at his firm's ambitious growth plans and asked: “How are we going to do this without enough staff?”

Technical skills, particularly in information technology, are lacking in many parts of the region, even India. One of the main concerns is that there are not enough skilled graduates to fill all the jobs being created in a vibrant sector. Nasscom, which represents India's software companies, has estimated that there could be a shortfall of 500,000 IT professionals by 2010. This means companies recruiting at job fairs in India are having to make lucrative offers to capture the most promising students. Even a junior software-engineer can expect to take home $45,000 a year.

There is also a severe shortage of good managers. A study by the McKinsey Global Institute predicts that 75,000 business leaders will be needed in China in the next ten years. It estimates the current stock at just 3,000 to 5,000. And that assessment could prove optimistic. The study, which covered a broad spectrum of businesses and surveyed more than 80 human-resources managers, found that less than “10% of Chinese job candidates, on average, were suitable for work in a foreign company.” In engineering, for example, graduates were criticised for being too immersed in theory and not enough in practice. It concluded that the available pool of engineering talent in China was no larger than that in Britain, which now has a mostly service economy.

China is even suffering from something of a brain drain. In recent years the Chinese have been able to travel abroad more freely to study and acquire skills. But many do not return. A recent report by the Chinese Academy of Social Sciences found that between 1978 and 2006, just over 1m Chinese went to study overseas and some 70% of them did not go back. The brightest are often tempted to stay abroad by local employers, because the competition for jobs has become global.

The skills shortage comes in two forms: higher staff turnover and rising wage costs. Pay rates for senior staff in many parts of Asia already exceed those for similar staff in much of Europe. The going rate for a human-resources director working for a medium-to-large multinational in Shanghai is now $250,000 a year, and that is for “someone who has probably never even left China,” says Vanessa Moriel, the managing partner of Human Capital Partners, a Shanghai-based consulting firm. The chief executive of an international business based in India can expect to earn $400,000-500,000, with many earning well over $750,000, according to Korn/Ferry, a consultancy. For a chief finance officer the average pay is now $194,000 in China, $159,000 in Thailand, $157,000 in Malaysia and $73,000 in India. Wages for lower-level staff are also rising quickly, increasing by 14% in Indonesia last year, 11% in India and 8% in

China—well above the rates of inflation in each country.

Another year, another job

A high staff-turnover rate helps to force up wage costs, and turnover-rates can exceed 30% a year in some places in Asia. Fiducia, a Hong Kong-based consultancy, reckons that the additional hiring and training costs of operating in Asia add a further 15% to the basic costs of employing someone. Factories in southern China now plan for a 4% loss of staff just in the week immediately after Chinese New Year, because people seem to like to start the new year with a new job. In middle management, the average retention period of an employee in Shanghai is just 1.8 years, with human-resources managers among the most difficult to keep. Some job applicants are known as “jumpers” because of their tendency to switch jobs every two years.

Struggling with high staff-turnover is harder still when many firms are also trying to expand. Last year Flextronics, a big electronics manufacturer, wanted to increase staff numbers in Shenzhen from 27,000 to 43,000. But to get a net increase of 16,000 people, it had to hire more than 20,000 because over the same period it had 4,000 employees leave.

As well as excessive wage inflation there is also “title inflation” and “responsibility inflation”. Relatively inexperienced local managers are sometimes given ever-grander titles—much to the chagrin of their counterparts from Europe and America, who can find themselves sitting beside much less able and more junior colleagues described as “Senior Executive Vice President” or “Regional Chairman”. But these honours are handed out for a reason: many employers in Asia have found that awarding new titles to employees every 18 months or so can be a good way to keep them.

Giving greater responsibility to staff is more troublesome. Yet many inexperienced managers in China are being given powerful regional roles or are promoted to positions where they lack sufficient knowledge or ability. Even though they may not seem ready for the job, it is often seen as the only way to keep them on the payroll.

A problem for years to come

As if all this were not bad enough, the Asian talent shortage is set to get worse. The predicted inflow of investment, together with the growth of local companies and the rising expectations of foreign investors—especially as other markets are slowing—mean that the pressure to find and keep staff is mounting.

Demography will also play a big role, especially as labour forces in both China and Japan shrink over the next two decades. This means, for instance, that the already difficult job of finding creative software-engineers will become ever harder in northern Asia, which in turn will increase demand for staff in India and other markets where demographic problems do not exist.

But that only points to an even bigger threat which may take a generation to fix: education. In much of South-East Asia most people are educated only to the age of 12. More than half of the women in India are illiterate. Nearly two-thirds of the children in government primary schools in India cannot read a simple story. Half cannot solve simple numerical problems.

China's educational difficulties are different—and often linked to the country's history. Universities were closed during the Cultural Revolution and few well-educated people entered the workforce for over a decade. This has resulted in a lost generation of business people between the ages of 50 and 60, exactly the age group from where many of China's corporate leaders should be drawn today.

Those who were children (and typically without siblings because of China's one-child policy) after the Cultural Revolution have other things to deal with. Their parents had often been sent for re-education in the fields and many were brought up far away from home by strangers. Perhaps in response to this harshness, they have brought up their own children rather indulgently. What is known as the “little emperor syndrome” is a particular weakness in boys. Many older Chinese believe this younger generation, doted on by grandparents and parents, lacks a work ethic. It has even become a bit of a slur to say of someone that “they were born in the 1980s”.

Girls born after the Cultural Revolution are much less likely to have been spoilt, which means some employers see them as good hires. Liam Casey, the boss of PCH China Solutions, a contract-manufacturer in southern China, says he once noticed in a shopping mall that there were typically groups of seven people or groups of three. The groups of seven consisted of two sets of grandparents, parents and a boy. Those of three comprised parents and a daughter. He says he realised then that girls were valued less by society and that if he hired them and showed them loyalty, they would be more loyal in return. This is one reason, he says, that his business has much lower rates of staff turnover than his rivals' businesses do.

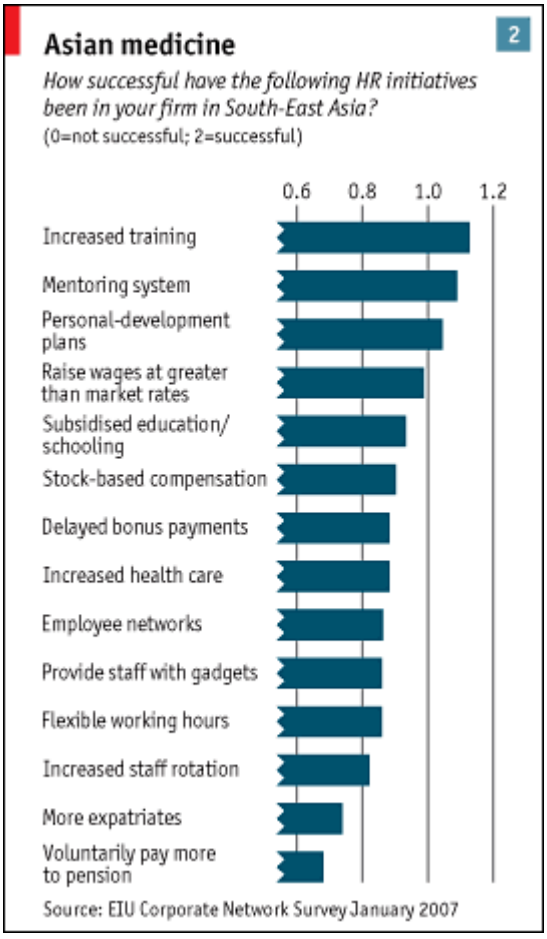
But even hiring women is getting harder. In Zhuhai another foreign manufacturer which hires staff from all over China says it prefers to recruit women too. The managers believe that women are generally harder-working and tend to stay longer. But schools and universities have cottoned on to this now and set quotas on the number of women that firms can recruit. The company says that for every group of women it selects, it now has to hire a share of men too.

Team building

In the face of so many problems, what can employers do? Building a skilled workforce is as much about a company's general attitude as its tactics, says Michael Bekins, the managing director of Korn/Ferry in Hong Kong. The first part of that mindset is realising that retention is more important than recruitment, he says. He thinks all managers in Asia should be explicitly measured on their ability to keep a team together.

Some ways of doing that are more obvious than others. Paying higher wages to employees, say most managers and recruitment specialists, is certainly not enough. Pay should be seen as only part of any package. Delaying bonus payments with a reward at the end of say, three years, can work well, but increases costs. Offering career planning, training, “personal-development road maps”, mentoring and the rest of the modern HR kitbag seems to go down well (see chart 2), though managing expectations is critical. One company in South-East Asia has a “welcome the boomerangers” policy, making it easy for anyone who has left to come back. The big accounting firms have programmes to keep in touch with people who leave.

Some employers argue that you should focus on the family not just the employee. Offering support for children's education and helping the families of staff resettle can build loyalty. With expatriates, this is crucial. According to one consultant, 85% of expatriates in China leave because their families do not like living there. Life can be especially hard in smaller cities, where there are few other foreigners, international schools or decent restaurants and little to do in your time off. Many spouses complain of feeling like prisoners in their gated communities while their partners are away, heady with the thrill of running the firm's fastest-growing division.



There are less obvious ways to keep people too. A prestigious brand can be valuable in more ways than one; Asians seem attracted to the idea of working for well-known firms. Having a fashionable office can be a big help. And providing courses in stress management or etiquette can be attractive. So is giving staff club memberships. Even providing staff with the latest PDAs and mobile phones can work wonders (see chart 2). And, if a company has a canteen, it should make sure it hires a good chef.

One of the more creative options for employers is to offer flexible working hours and sabbaticals. Although these are unusual in Asia, they can help staff who have young children or elderly parents to care for. But there are some dangers. It is common, especially in China, for employees to run private businesses on the side. Giving them more time for outside activities may not be in a company's best interests. It could also be counterproductive in some parts of Asia, were workers

want a job in order to make as much money as fast as they can.

Hiring Asians who have been educated overseas and bringing them back does not always work. They often expect to be paid a lot. Some demand expatriate packages with paid flights back to America or Europe. They may also be out of touch with local developments. But the biggest difficulty is that their colleagues frequently resent them. This is especially so in China, where one of the politer names for returning people is *hai gui* or sea turtles. A similar attitude sometimes turns up in India too. Companies find that the turtles tend to fit in best in the finance industry or in privately owned businesses.

With such a mismatch between supply and demand in Asia's labour markets, companies will have to become better at hiring good staff and keeping them. But as some companies will always be better at this than others, the job-hopping and poaching are set to continue for many years, until education and training catch up. The consequences of that are stark. “It will limit the growth. It has to,” says Korn/Ferry's Mr Bekins. Which means that without talented recruiting policies, some firms may end up scaling back their bold Asian growth-plans.

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Banks in trouble

The game is up

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Illustration by Satoshi Kambayashi

In a special section, we look at how trouble in the credit markets has led to a crisis of confidence in global finance

THE old-fashioned financial system was like Old Maid, a parlour game once beloved of small children. The banks were like players, dealt hands from a pack of cards, which they swapped among each other. At the end, one player was left holding a lonely queen—a bad debt, if you will—and lost. Over the past few decades the game has changed. Securitisation has snipped the old maid into pieces; new faces, such as hedge funds, have joined the party, enabling the banks to distribute those pieces among a larger number of players. When the game is over, lots of players are left holding small losses instead of one player holding a big one.

During two exceedingly prosperous decades, that theory seemed to work just fine. But the swings in almost all financial markets this month have made dispersed risk suddenly morph into dispersed mistrust. The uncertainty has been magnified by the way that bad risks have become so hard to value. Investors have bought asset-backed securities that use shaky subprime mortgages in America as collateral, but as defaults have risen, the value of that collateral has tumbled. Meanwhile, collateralised-debt obligations (CDOs), made up of clumps of those securities and laced with leverage, have become almost impossible to trade. So none of the players really knows how much he has lost. While this uncertainty lasts, investors are taking it out on the banks that peddled the securities by dumping their shares; and the banks are taking it out on those they sold them to by demanding more collateral on their loans. The banks have even grown cagey about lending to each other.

The doubts burst into the open on August 9th when central banks were forced to inject liquidity into the overnight money markets because banks were charging punitive rates to lend to each other. At first, the problems appeared more serious among European banks, especially in Germany, where low profitability among state banks led them to take risky bets in subprime markets. The pain in America was concentrated in the largest hedge funds, including those run by Wall Street's biggest name, Goldman Sachs. Increasingly, however, analysts worry about the exposure of American, Canadian and Asian banks to mortgage-backed securities and especially those funded by short-term commercial paper that is becoming increasingly hard to roll over. On August 15th shares in Countrywide Financial, a large American mortgage lender, fell 13% after a Merrill Lynch analyst abruptly changed his buy rating on the stock to a sell, warning of possible funding difficulties. Despite a large liquidity injection by the Federal Reserve on August 15th, the S&P 500 index fell 1.4%. The heavy selling spread to Asian stocks on August 16th.

Every crisis begets finger-pointing, and the blame now is falling on the rating agencies that helped structure these exotic instruments. The European Commission is understood to be reviewing why rating

agencies failed to move more quickly in response to the growing crisis in subprime mortgages. Currently, they are guided by a voluntary code that aims to tackle potential conflicts of interest. The biggest is that the agencies are paid by the firms they rate. Rating CDOs was a profitable business.

To understand why so much blame is being heaped on the rating agencies, consider how CDOs and collateralised-loan obligations (CLOs) came into vogue. In the mid-1990s individual loans looked appealing to investors, but their ratings (often below investment grade) made them too risky for conservative types. So whole forests of asset-backed securities were put together into a single CDO. These were structured so that the first losses would be taken by whoever had bought the riskiest, highest-yielding piece of the package. That piece had a low rating. But the piece at the top, which would take the last losses, was rated AAA—a reflection of how unlikely it was that all the loans in the CDO would default at once.

Rather than standing back and observing this from the sidelines, the rating agencies got involved in structuring these products. Like schoolgirls asking for help with their homework, the banks would go to the agencies and ask how the different slices of the CDOs they were putting together would score. The agencies would suggest improvements based on their models. And lo, the senior tranches were given the ratings required to market them to banks, which liked the security the triple-A ratings conferred, especially because their yields were higher than those of American Treasuries.

If these securities are now downgraded, the same banks could be forced to offload lots of illiquid instruments into a falling market—one of the fastest ways to lose money yet devised. But if there are no buyers, banks may have to sell something else to shore up their balance sheets.

Something like this indiscriminate selling has been affecting hedge funds over the past couple of weeks. Faced with more demanding standards from their banks and investors, some have been forced to unwind positions in order to realise cash. That has led to unusual movements in debt and equity markets, which have only got some funds deeper into trouble. Quantitative funds have been hardest hit, as investment models that had made money for ages briefly proved worse than useless.

Goldman Sachs admitted as much when it said that its funds had been hit by moves that its models suggested were 25 standard deviations away from normal. In terms of probability (where 1 is a certainty and 0 an impossibility), that translates into a likelihood of 0.000...0006, where there are 138 zeros before the six. That is silly.

Since banks lend to hedge funds, any problems there quickly become their concern. On top of this, both Bear Stearns and Goldman Sachs have found that when funds bearing their name get into trouble the desire to preserve their reputations soon leads to a rescue. Sometimes risk is not as far away from the banks as it seems.

At the end of Old Maid as banks used to play it, the loser would take a big write-off and then everyone could start playing again. In the new version, the use of leverage means the game is being played with hundreds of packs of cards and by thousands of different players. “Securitisation,” says Avinash Persaud of Intelligence Capital, a financial adviser, “has meant that credit risks have moved from knowledgeable, long-term hands, to fast hands, where the principal risk-management strategy is to sell before prices fall more”. Working out who has won and who has lost in this round will take a long time.

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A liquidity squeeze

Bankers' mistrust

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Central banks struggle to prevent money markets from drying up

LED by Alan Greenspan, the former chairman of the Federal Reserve, most central bankers think arm's-length lending and derivatives have made the financial system work better. But everyone has been tripped up by the rapid way difficulties with American subprime mortgages, on the outer reaches of the debt markets, have infected interbank lending, supposedly one of the safest and most liquid areas of financial markets. Central banks have spent most of this week shoring up the interbank market. By August 16th the effort had spread right across Asia.

The interbank market lubricates the financial system by moving cash to where it is most needed. The price that banks charge each other for short-term lending is closely aligned with the interest rate set by the central bank, the ultimate font of cash.

On August 9th and 10th the rates commercial banks charge each other for overnight borrowing spiked on both sides of the Atlantic. In America the rate hit almost 6% (see chart), well above the Fed's target of 5.25%. In the euro area, money market rates peaked briefly at 4.7% sharply above the benchmark of 4%. On any normal business day the spreads would be only a few hundredths of a percentage point.

The European Central Bank (ECB) was quickest to respond, with the first of a series of unscheduled “fine-tuning” operations. It provided €95 billion ($131 billion) of extra funds to the money market on August 9th. This was more than it supplied on the day after the terror attacks of September 2001. On August 10th the ECB supplied €61 billion. Central banks from Canada to Japan and Australia followed. America's Federal Reserve acted too, injecting $24 billion on August 9th and $38 billion the following day. Although these measures looked less dramatic than the ECB's move, they were much larger than normal for the Fed.

The ECB's extravagance sparked fears that it knew about a nasty problem in European banking. There are likelier explanations. Higher reserve requirements in the euro zone mean that its central bank has to inject more cash than the Fed to achieve the same effect, says Julian Callow at Barclays Capital. By acting first and forcefully, the ECB may have eased the need for other central banks to step in. With fresh euro reserves as collateral, banks found it easier to borrow in overseas markets. Moreover, the Fed's operation on August 10th was also slightly unorthodox, as the collateral for cash loans was entirely in mortgage-backed securities, albeit ones guaranteed by federal agencies.

The immediate cause of the spike in the interbank market appeared to be an announcement by BNP Paribas, a French bank, that it was suspending withdrawals from funds invested in illiquid (and thus hard-to-value) credit securities. But banks were already on edge after IKB Deutsche Industriebank, a German lender, had to be rescued because of its reckless exposure to American mortgages.

Lenders who cannot distinguish good borrowers from bad become less willing to lend to anyone. Even cash-rich banks will hoard their money if they fear that the interbank market will seize up and cut them off from sources of future supply.

The injection of fresh cash by central banks eventually succeeded in pushing money-market rates back down. The ECB's fine-tuning lasted four days, with each injection of loans smaller than the last.

Some have criticised the central banks for their “bailout”. But this was nothing of the sort, because the

central banks loaned the extra money at prevailing policy rates for short periods (short enough, as it happens, not to be inflationary). Others argue that the loans should have been at punitive rates, to deter banks from coming to the central bank cap in hand. Yet it would have made no sense to punish the entire banking network for a lack of confidence.

Ready supplies of liquidity are reassuring in the short-term. But do they address the real problem? One drawback of a system that disperses risk is that nobody knows who has lost how much. Another is the way that bad news comes to light in dribs and drabs, rather than in one cathartic revelation. Even now, there are lingering traces of mistrust in longer-term interbank lending rates, which still look unduly high compared with overnight lending.

Markets are jumping at every shadow. Only when the imagined bad news has been flushed out will interbank markets return to obscurity.

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Funding difficulties

A conduit to nowhere

Aug 16th 2007 | FRANKFURT AND LONDON
From The Economist print edition

Even conservative banks are rumbled by risky credit-arbitrage funds

MANY banking crises have had their roots in property: America's in 1988, Sweden's in 1992, Germany's earlier this decade. What is strange about the latest turmoil is that some of the biggest losses for banks have come to light far from America's subprime-mortgage market where they began. In February HSBC, a British bank, was one of the first big institutions to acknowledge steep losses in underwriting loans to Americans with poor credit scores. Six months later, a German bank, IKB Deutsche Industriebank, came close to failure because of its exposure to securities backed by the same sort of American loans.

On August 13th it was Canada's turn to take centre stage in the drama, when Coventree, a niche Canadian investment bank, declared it was seeking liquidity funding of up to C$700m ($660m). The same day, 17 other Canadian funds sought to secure bank credit-lines. Coventree claimed some of its liquidity providers had refused to provide needed cash, without specifying who they were. The next day Coventree's shares soared after it said it had found funding.

As the problems have spread, analysts have turned their attention to other Canadian banks, American banks like Citigroup, German Landesbanks—wholesale banks, such as WestLB and SachsenLB—and large British groups like Lloyds and HBOS. The worries have dragged down the world's stockmarkets (see chart).

Concerns are focused on investment vehicles, known as conduits, which are mostly kept off banks' balance sheets and are funded in the asset-backed commercial-paper (ABCP) market. The loans are typically cheap, usually roll over every few months, and are used to buy highly rated, but high-yielding assets, such as collateralised-debt obligations. The risk of using short-term funding was always one of liquidity—and it dried up quickly once lenders became spooked. With triple-A rated assets, that had not been expected to become a problem. But the malaise spread to the sponsoring banks that typically provide “temporary” back-up credit.

Conduits have been hugely popular in both North America and Europe, partly because their high ratings may eventually enable banks to reduce their regulatory capital and partly because they pay far better than, say, similarly rated American Treasuries. The first sophisticated conduits were established around 1998 by BayernLB and WestLB, two German Landesbanks. By the end of March some $507 billion of ABCP assets were in European conduits, according to Citigroup. The global ABCP market is estimated at $1.2 trillion, up from $650 billion three years ago.

Yet the structured-finance geniuses did not stop at conduits. They ventured into structured investment vehicles (SIVs), which are similar, but more highly leveraged. SIVs have been one of the fastest-growing areas of structured finance, and they have been investing in riskier assets; Standard & Poor's, a rating agency, estimates 23% of SIVs' assets are in residential mortgage securities, half of which are American. They come with little bank credit-line support in a liquidity crunch, and rely on a cushion of surplus money or insurance called “credit enhancement”. To reassure their lenders, SIVs' assets are marked-to-market daily, which is hard because no one in the market wants to buy some types of asset-backed securities.

Making matters worse, some banks even manage SIV-lites (echoing the covenant-lite trend of the leveraged-loan market). These have fewer diversification restrictions and involve borrowings of up to 40 to 70 times equity collateral. Most SIV-lites made big, focused investments in American mortgage securities, including subprime and Alt-As, which are also troubled in spite of their better credit quality.

One of the busiest in these markets is Deutsche Bank, Germany's biggest bank. In a March filing with America's Securities and Exchange Commission it estimated its maximum exposure to loss from structured products at €2.3 billion ($3.1 billion). But it will not, indeed cannot, put a number on its exposure now. It is the same at other big European banks, such as Royal Bank of Scotland or HSBC.

More worrying are the exposures of some German Landesbanks. On August 13th DBRS, an international rating agency, noted that rumours had been circulating for a week about the liquidity of some German banks, especially after IKB's state-sponsored bail-out. Part of the problem, it noted, was that investors no longer trusted the ratings of the asset-backed securities that the banks had invested in. And who can blame them. As late as June, Moody's issued a report calling SIVs “an oasis of calm in the subprime maelstrom”.

WestLB, and SachsenLB, with conduit or SIV portfolios totalling €35 billion and €17 billion respectively, may have been acting pragmatically. Until July 2005 these banks were able to issue a huge amount of long-term debt, which is guaranteed by the state until 2015. WestLB's line of credit to its conduit, Greyhawk, is also state guaranteed. The market knows, and the banks know, that a Landesbank will not be allowed to fail. Most banks elsewhere do not have that luxury, however. Which is why investors are so nervous.

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Hedge funds

Behind the veil

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From The Economist print edition

Big market losses provide insights into a volatile financial world

Get article background

THEY are secretive, clever and often highly lucrative. But the veil of mystery that has shrouded hedge funds was partially lifted in the past fortnight after market turmoil left many of them with big losses—and anxious investors.

Insiders say the losses were caused by a mixture of human and computer-driven error. In early August some prime brokers—the institutions that lend money to hedge funds—were worried about the way losses were spreading from America's subprime mortgage market. So they issued margin calls, asking them to increase the collateral on deposit against the risk of default. At about that time, many hedge-fund managers were beginning to feel the worst of the crisis was over, and that the soundness of the global economy would generate a late-summer rally. Early last week, stocks duly soared. But the margin calls forced funds to liquidate good assets, and the cross-currents of buying and selling sent markets into a tailspin.

Among the hedge funds hardest hit were credit funds and those using a type of statistical arbitrage, known as long-short equity neutral. Stocks in these portfolios are picked assuming certain shares will rise and others will fall. In this case, the complex models that drive them were upended by the extreme market volatility. Four building-blocks of such models are stock valuations, quality, price momentum and earnings momentum. These usually offset each other, but when they all started suffering, the models went awry. Some of the world's biggest hedge funds all began selling the same things at the same time. “You had the proverbial camel trying to get through the eye of the needle,” an analyst says.

Although the pain was not confined to hedge funds—some long-only mutual funds were also hurt—the use of ample leverage (a staple in the hedge-fund world) meant they were hardest hit. One big investment bank is said to have offered leverage of 20-to-one to hedge funds investing in subprime mortgages just months ago.

In a conference call on August 13th, Goldman Sachs said its leading global equity fund—which relies on a quantitative trading model—had lost more than 30% of its value within a week. The bank waived fees to attract investors to the fund after it lost about $1.4 billion in assets. The bank pumped in about $2 billion of its own money and received another $1 billion from outside investors. Renaissance, a successful “quant” fund founded by James Simons, a prize-winning mathematician and former code breaker, also suffered steep losses. “You have no idea of the stress. Many funds wondered if they would survive,” says a hedge-fund manager, noting that many hedge funds sought out new investors last weekend.

The fall-out was not limited by geography. Quantitative hedge funds in Japan were among the worst affected, according to Manolis Liodakis, head of global quantitative research at Citigroup. The pain also spread to Europe.

The extent of losses is not yet clear. Many funds will report to their investors in the coming weeks. Much depends on whether the pension funds, endowments and rich individuals investing in hedge funds hold their nerve. The “lock-up” periods for fund investors vary. Many allow redemptions only monthly or quarterly. August 15th was a big day for those who need to give 45 days notice before redeeming their stakes by the end of September.

The saga has damaged the image of computer-driven funds, generally so powerful that they can account for up to half of a stock exchange's daily trading volume. But there is no way the clocks will be turned back. “People aren't going to give up their computers and go back to insider information and tips,” says David Harding, a fund manager in London.

It is also unclear who will gain from the turmoil—and someone always takes the upside of losing trades. Market volatility meant that some funds that plunged last week had recouped most of their gains within a few days. Timing was all. Goldman Sachs' investment in its own fund may look like a clever move in retrospect. Top executives at the bank insisted the highly unusual gyrations were “way out of whack” with their models. Clearly the models were flawed. But Goldman's backers, such as Hank Greenberg, the former chairman of AIG, an insurer, were not acting out of charity.

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Financial contagion

Mortgage flu

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Turmoil in America's mortgage market has spread far and wide

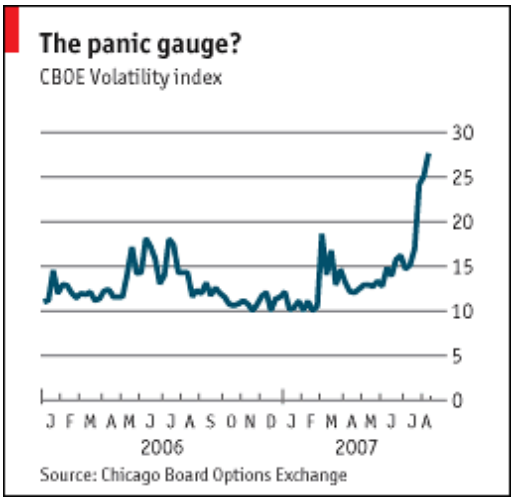
IF THE speed with which financial-market turmoil has spread around the world has been unnerving, fears of an even more alarming form of contagion are surfacing: it may undermine America's economy.

The health of the world economy is the main source of optimism at a time of unstable markets. But Hank Paulson, America's treasury secretary, acknowledged this week to the *Wall Street Journal* that the turmoil would "extract a penalty on the growth rate" of the American economy.

Stockmarket investors are already worried that problems in the housing market are sapping the economy's vigour. This week Wal-Mart, the world's biggest retailer, added to fears when its boss said that American consumers—who have helped underpin economic growth—face pressures and that the retailer's profits this year would suffer. Its share price duly tumbled on August 14th, helping to drag down the market. Sagging confidence, as a result of falling markets and troubles in the banks, would only make matters worse.

The problems are not confined to America. Subprime mortgage losses have hit bank shares and stockmarkets around the globe. Fear that tighter debt markets will inhibit leveraged buyouts that pushed share prices higher in the first half of the year has cast a shadow over the world's stockmarkets. Volatility, which still reflected complacency in the American stockmarket many months after the subprime problems erupted, now registers something approaching panic (see chart).

As margin calls have forced hedge funds to raise cash, that has often meant purging their most liquid assets, such as oil. Speculative selling, as well as fears about the health of the American economy, have dragged oil prices well below their peak of $79 per barrel in late July. *The Economist*'s metals index is 14% below its highs in May.



Shares in Asian banks, such as Mizuho and Australia's Macquarie, have had a miserable month, pushing down the region's stockmarkets. On August 15th Basis Capital, an Australian hedge-fund manager, said losses at one of its funds may top 80%. A day later, shares in RAMS, one of the country's mortgage lenders, tumbled 60% after it sought emergency funding.

The market turmoil has even extended into what are meant to be the safest—nay, dullest—corners of the investment universe. On August 14th Sentinel Management Group, which invests on behalf of traders in conservative investments in the money market, attempted to halt withdrawals because of the market turmoil. "We had previously thought that the market would return to some semblance of order and that our clients would not join in the panic. Unfortunately, this has not been the case," it complained.

Similarly, there has been pain in some "enhanced cash funds"—in effect, money-market funds catering to institutional investors that can invest part of their portfolios in asset-backed securities. The flu has battered down even the hardiest parts of the immune system.

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Japanese foreign exchange

Not-yet-desperate housewives

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Is Mrs Watanabe doing her bit for global stability?

Get article background

IN MOST of the world in the past week, attention has been on highly leveraged hedge funds that have been forced to dump assets bought on margin. In Japan, however, a different species of margin trader has—until now, at least—stood firm: the housewife. On her shoulders may lie responsibility for some of the stability of the global financial system.

On August 15th the Japanese currency climbed to a 4½-month high against the dollar and continued to surge against the New Zealand dollar, raising concerns about the sustainability of the carry trade, through which investors borrow in cheap yen to buy higher-yielding assets elsewhere. This had made fortunes for international investors but, lately, Japanese retail investors had become the carry trade's greatest enthusiasts. The metaphorical Mr and Mrs Watanabe account for around 30% of the foreign-exchange market in Tokyo by value and volume of transactions, according to currency traders, double the share of a year ago. Meanwhile, the size of the retail market has more than doubled to about $15 billion a day.

One reason for the surge is margin trading. Brokers are offering leverage of as much as 200 times the down-payment (though the average is more like 20 to 40 times). In July Japanese retail investors' short positions on the yen (a bet that it would fall) exceeded the amount taken by traders on the Chicago Mercantile Exchange, a foreign-exchange trading hub. “The gnomes of Zurich were accused in their day of destabilising markets. The housewives of Tokyo are apparently acting to stabilise them,” boasted Kiyohiko Nishimura, a Bank of Japan board member, in July.

Strikingly, as the yen appreciated, retail traders, rather than dump their positions, saw a buying opportunity and sold yen for other currencies, softening its rise. “The Japanese government has not intervened—they've not had to, because the Watanabe-*san*s have been selling yen for them,” says James Gow of FXOnline Japan, a retail broker.

However, many institutions are unwinding their carry trades. In the last week alone, the yen has risen 10% against the New Zealand dollar. The fear is that, as investors buy yen, the losses for the remaining carry traders will balloon. If retail investors, too, lose faith, it could set off a stampede that would further disrupt global markets.

On the other hand, there may still be grounds for the carry trade to continue. Compared with other countries, the interest-rate differential remains attractive. Given the global credit turmoil, it is also looking less likely that the Bank of Japan will raise rates to 0.75% from 0.5% at its meeting on August 23rd. Whatever happens, Mrs Watanabe is on guard.

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A credit crunch in cyberspace

Trouble in paradise

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The banking crisis finds an echo in Second Life

IN VIRTUAL worlds you may be able to fly, but the laws of economic gravity still apply. Last week, when real-life financial markets suffered a credit crunch, Second Life, the much-ballyhooed 3D online world, experienced its first bank run. This featured avatars, electronic alter egos, lining up in front of virtual teller machines, trying to withdraw so much money that it forced the bank, Ginko Financial, to cease operations and turn deposits into perpetual bonds. Some predict that the virtual economy is in for its first financial crisis.

Withdrawal symptoms

Such fears seem overdone. In contrast to real life, financial institutions do not play a big role in Second Life's economy. It is dominated by land speculation, the sale of digital objects, such as attractive body parts for new avatars, and gambling—until it was outlawed last week for legal reasons, possibly triggering the bank run.

That said, Second Life is certainly gripped by irrational exuberance, paralleling all those risk-blind investors in dubious derivatives. When a new audience discovered the virtual world last autumn, it seemed to have found a second paradise. The press loudly sang its praises. Not wanting to miss out on the next big thing, scores of well known real-life companies, such as Coca-Cola and IBM, set up shop in the virtual world. Attracted by features, such as teleportation and the possibility to make some Linden dollars (which can be exchanged into real bucks), new users signed up at a rate of nearly a million a month.

All this transformed Second Life into an extremely fast-growing economy, if you believe the numbers of Linden Lab, the service's San Francisco-based owner. It grew by 15-20% a month during the past two years. And until recently, Linden Lab could not add servers fast enough to meet the demand for additional virtual land, which must be bought for real dollars, an important source of revenue for the outfit. The digital territory has thus expanded to more than 700 square kilometres—about eight times the size of Manhattan.

Yet even before Ginko's collapse, public opinion had turned against Second Life. This was in part because of the media backlash typical with an over-hyped technology, but also because reality has intruded online. Many users experience this parallel world as a lonely one, despite the existence of 7.7m registered residents as of June. Only 10% of new users are still active after 30 days and at any given time only between 20,000 and 50,000 are logged on. Most corporations hardly attract any online visitors, which is

why some firms have already closed their branches. Real money is being made by only a happy few.

Still, Second Life is unlikely to experience the same hard landing as the market for subprime mortgages. In fact, compared with other virtual worlds before it, Second Life's economy and its currency have been tightly managed. To ensure that the Linden dollar does not stray too widely from an exchange rate of L$270 to the American dollar, Linden Lab uses a set of monetary instruments, allowing it to inject or mop up liquidity. It also intervenes on a Second Life currency exchange, called LindeX, which even features automatic circuit breakers if trading gets too frantic.

The real economic policy tests, however, are yet to come. Will Linden Lab be willing to prop up its currency if growth slows down (which it apparently already has begun to do) or if many users start selling their Linden dollars? Will the firm, which so far has preferred a laissez-faire approach, introduce regulation, to avoid further bank runs, say? If Second Life has trouble answering such questions, it can take solace from the fact that they are proving pretty tricky in real life too.

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Economics focus

What would Bagehot do?

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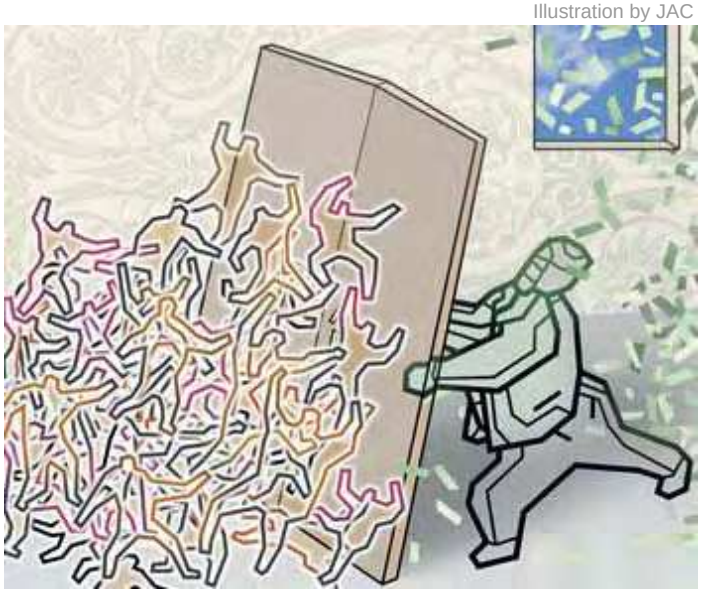
Illustration by JAC



Should central banks act as buyers of last resort?

HOWEVER much marble they lay in their foyers, banks have typically been brittle institutions. They borrow short (collecting deposits or short-term loans that might have to be repaid quickly) and lend long (making loans that cannot easily be converted into cash at anything close to their value to the bank).

A bank is solvent if its assets are worth more than the money it owes to its depositors and creditors. As long as its depositors believe that their money is safe, their faith is rewarded. But even a solvent bank can be broken by a bank run. If depositors fear that others will withdraw their money, making claims on the bank's reserves of cash, nobody will want to be last in line. Since a bank cannot redeem more than a fraction of its deposits at any one time, the depositors' rush to escape with their money paradoxically ensures that some of them will lose it.

The damage may not stop there. A run on one bank can shake faith in another, if only because depositors have no reliable way to distinguish between sound and unsound institutions. As the banking system comes under threat, the supply of credit to businesses and households will be interrupted. And since cheques and other payments are often drawn on bank accounts, the payments system can come under strain.

In “Lombard Street”, his 1873 account of the money markets, Walter Bagehot urged the Bank of England to stave off such panics by lending “quickly, freely and readily”, at a penalty rate of interest, to any bank that can offer “good securities” as collateral. When this newspaper laid out these principles in September 1866, they were described by a director of the Bank of England as “the most mischievous doctrine ever broached in the monetary or banking world in this country”.

But as Bagehot pointed out, by lending liberally, central banks make it less likely that their money will be needed. By demanding good collateral, the central bank can try to distinguish insolvent banks from illiquid ones; and by charging a penalty rate of interest, it ensures that it is truly the lender of last resort.

Bagehot's mischievous doctrine is now conventional wisdom among central banks, as last week's events dramatically demonstrated. First the European Central Bank and then the Federal Reserve intervened liberally, lending against good collateral. They departed from Bagehot only in not charging a penalty rate.

Bank architecture has moved on since Bagehot's day: neo-classical columns giving way to glass atriums. Their position in the financial architecture has also changed. Companies that would once have turned to a

bank for an overdraft or a loan now sell paper or bonds to the market. Home mortgages are now bundled into securities and sold on.

But as the past few weeks have shown, the financial system remains brittle. Hedge funds, for example, have ventured into thinly traded securities, such as collateralised-debt obligations (CDOs), that nowadays are easy to dispose of only in the mathematical models they use to value them. On the other side of the balance sheet, the funds have short-term financing from multiple sources. If a fund starts to show losses, its backers may lose faith in its trades. But even if they believe it will eventually make money, they might grow nervous about the fund's other backers. Just like a nervous depositor eyeing the queues in front of a bank, one hedge-fund creditor may demand its collateral before everyone else grabs theirs. If, to muster collateral, a fund is forced to sell assets into a falling market, a profitable trade can quickly become unprofitable. In this way, seasons of alarm “beget the calamities they dread,” as Bagehot put it.

Should anyone else care? Some of the buyers of CDOs are big enough that their failure can hit the banks that sponsor or finance them. It could also cause the credit markets to seize up, interrupting the provision of finance to the economy. What would Bagehot do in such circumstances? Making it cheaper for banks to lend to each other is a rather indirect method of intervention. The Fed's rate cuts in the autumn of 1998, as Long-Term Capital Management, a big hedge fund, neared collapse, allowed banks to pick up the pieces as the capital markets came unstuck. But such tactics might not always do the trick.

The new mischief-makers

Willem Buiter of the London School of Economics and Anne Sibert of Birkbeck College, London, have advocated their own mischievous doctrine*. They think central banks should become “market-makers of last resort”, setting a price for securities that can no longer be sold on “orderly” markets because distress sales are pushing prices far below their fundamental value.

The central bank could make a market in CDOs, say, either by accepting them as collateral or by buying them outright. In either case, it would have to make up its mind about the underlying risk of such instruments and an appropriate penalty price. If it gets its calculations wrong, the central bank may lose money and face. But, the two authors say, preserving financial stability is more important than “covering the central bank's posterior”.

The bigger danger is that the central bank might make the next crisis more likely if it goes too far to protect investors' posteriors in this one. After all, they should anticipate that a security might not be easy to trade. But they won't deal with this “liquidity risk” if they can rely on the central bank to create a liquid market in whatever security has got them into trouble.

Banks, in return for the protection offered by a lender of last resort and by deposit insurance, accept restrictions on how far they can extend themselves. Mr Buiter thinks that hedge funds should not enjoy the protection of a central bank until they too are willing to accept analogous restrictions. In the meantime, perhaps they should lay more marble in their foyers.

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* maverecon.blogspot.com/2007/08/central-bank-as-market-maker-of-last.html.

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Statistics and climatology

Gambling on tomorrow

Aug 16th 2007
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Modelling the Earth's climate mathematically is hard already. Now a new difficulty is emerging

Illustration by Dettmer Otto

“SCIENCE” is a recently coined word. When the Royal Society, the world's oldest academy of the discipline, was founded in London in 1660, the subject was referred to as natural philosophy. In the 19th century, though, nature and philosophy went their separate ways as the natural philosophers grew in number, power and influence.

Nevertheless, the link between the fields lingers on in the name of one of the Royal Society's journals, *Philosophical Transactions*. And appropriately, the latest edition of that publication, which is devoted to the science of climate modelling, is in part a discussion of the understanding and misunderstanding of the ideas of one particular 18th-century English philosopher, Thomas Bayes.

Bayes was one of two main influences on the early development of probability theory and statistics. The other was Blaise Pascal, a Frenchman. But, whereas Pascal's ideas are simple and widely understood, Bayes's have always been harder to grasp.

Pascal's way of looking at the world was that of the gambler: each throw of the dice is independent of the previous one. Bayes's allows for the accumulation of experience, and its incorporation into a statistical model in the form of prior assumptions that can vary with circumstances. A good prior assumption about tomorrow's weather, for example, is that it will be similar to today's. Assumptions about the weather the day after tomorrow, though, will be modified by what actually happens tomorrow.

Psychologically, people tend to be Bayesian—to the extent of often making false connections. And that risk of false connection is why scientists like Pascal's version of the world. It appears to be objective. But when models are built, it is almost impossible to avoid including Bayesian-style prior assumptions in them. By failing to acknowledge that, model builders risk making serious mistakes.

Assume nothing

In one sense it is obvious that assumptions will affect outcomes—another reason Bayes is not properly acknowledged. That obviousness, though, buries deeper subtleties. In one of the papers in *Philosophical Transactions* David Stainforth of Oxford University points out a pertinent example.

Climate models have lots of parameters that are represented by numbers—for example, how quickly snow crystals fall from clouds, or for how long they reside within those clouds. Actually, these are two different

ways of measuring the same thing, so whether a model uses one or the other should make no difference to its predictions. And, on a single run, it does not. But models are not given single runs. Since the future is uncertain, they are run thousands of times, with different values for the parameters, to produce a range of possible outcomes. The outcomes are assumed to cluster around the most probable version of the future.

The particular range of values chosen for a parameter is an example of a Bayesian prior assumption, since it is derived from actual experience of how the climate behaves—and may thus be modified in the light of experience. But the way you pick the individual values to plug into the model can cause trouble.

They might, for example, be assumed to be evenly spaced, say 1,2,3,4. But in the example of snow retention, evenly spacing both rate-of-fall and rate-of-residence-in-the-clouds values will give different distributions of result. That is because the second parameter is actually the reciprocal of the first. To make the two match, value for value, you would need, in the second case, to count 1, ½, ⅓, ¼—which is not evenly spaced. If you use evenly spaced values instead, the two models' outcomes will cluster differently.

Climate models have hundreds of parameters that might somehow be related in this sort of way. To be sure you are seeing valid results rather than artefacts of the models, you need to take account of all the ways that can happen.

That logistical nightmare is only now being addressed, and its practical consequences have yet to be worked out. But because of their philosophical training in the rigours of Pascal's method, the Bayesian bolt-on does not come easily to scientists. As the old saw has it, garbage in, garbage out. The difficulty comes when you do not know what garbage looks like.

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Modelling the climate

Tomorrow and tomorrow

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A group of climatologists discover reality

WHILE some argue about the finer philosophical points of how to improve models of the climate (see article), others just get on with it. Doug Smith and his colleagues at the Hadley Centre, in Exeter, England, are in the second camp and they seem to have stumbled on to what seems, in retrospect, a surprisingly obvious way of doing so. This is to start the model from observed reality.

Until now, when climate modellers began to run one of their models on a computer, they would "seed" it by feeding in a plausible, but invented, set of values for its parameters. Which sets of invented parameter-values to use is a matter of debate. But Dr Smith thought it might not be a bad idea to start, for a change, with sets that had really happened. He therefore gave his models a series of decade-long tests beginning with the real climatic conditions (level of solar radiation, ocean temperature and so on) on 80 different start dates from 1982 to 2001.

As he reported recently in *Science*, the use of such real starting data made a huge improvement to the accuracy of the results. It reproduced what had happened over the courses of the decades in question as much as 50% more accurately than the results of runs based on arbitrary starting conditions.

Hindcasting, as this technique is known, is a recognised way of testing models. The proof of the pudding, though, is in the forecasting, so Dr Smith plugged in the data from two ten-day periods in 2005 (one in March and one in June), pressed the start button and crossed his fingers.

The results suggested that the world would cool from February this year until 2009. After that, it will start warming up again, with at least half of the years between 2010 and 2014 being warmer than 1998, the hottest on record so far.

Given the rainy British summer this year, the view from north-west Europe is that the new way of doing things is spot on. Shame it took so long to think of it.

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Storing electricity

It looks good on paper

Aug 16th 2007
From The Economist print edition

Cellulose and nanotubes combine to bring flexible batteries to the world

ELECTRICITY-storage devices are getting more flexible, in a literal sense as well as in their design. This week saw the unveiling of the most robust but flexible battery ever reported. Pulickel Ajayan and his colleagues at Rensselaer Polytechnic Institute in New York made it by mixing carbon nanotubes (cylindrical, electrically conductive molecules made of carbon atoms) with cellulose, the stuff of paper. The result, which they reported in the *Proceedings of the National Academy of Sciences*, is an energy store that is cheap, flexible and paper-thin.

Broadly speaking, devices for storing electricity come in two varieties: batteries and capacitors. Batteries contain lots of incipient electricity in the form of chemicals that, when they react, can be used to generate an electric current. Such “high energy-density” devices, however, release their potential slowly. For a short, sharp shock a capacitor is better. This is a low energy-density device, which stores electricity directly by charging two conductive plates with static. One plate is positive, the other negative. When the two plates are connected as part of a circuit, the charge flows rapidly between them and produces a far more powerful current than a battery can. This is ideal for applications such as camera flashes.

The delightful thing about Dr Ajayan's device is that with suitable tweaking it can be used as a capacitor, a battery, or both. A sheet containing two layers of nanotubes is a capacitor (each layer acts as a plate). A sheet containing one layer, but with a coating of metallic lithium on the other side, acts as a lithium-ion battery. A sheet with two layers of nanotubes and a lithium coating can be switched from one application to the other as required.

The crucial component for making this material is an exotic solvent called 1-butyl, 3-methylimidazolium chloride. This molecular mouthful has the rare ability among solvents of being able both to dissolve cellulose and to act as an electrolyte—that is, a chemical that can carry current between the electrodes of a battery in the form of charged molecules, or ions. It is thus integral both to the manufacturing process of the device and to its operation.

The result is a material that works at temperatures from –80°C to 180°C, and can be rolled up, folded or cut like paper with no effect on its performance. It could be attached to folding solar panels of the sort used in space missions, and back on Earth it could provide portable power in deserts or at the poles.

The three-layer version, in particular, provides a unique hybrid power supply. It has the characteristics needed for applications that require both high-power pulses and steady, battery-like flow. Moreover, it provides them both while it is discharging and while it is being re-charged. Hybrid cars are one application for these characteristics. Many use dynamos to recover their energy of motion when they brake. The recovered energy is normally stored in a battery. But such a car needs a burst of energy to get going again. Dr Ajayan's device could provide this more effectively than a conventional battery.

Like the cells of a conventional battery, layers of the new device can be stacked together to increase their output. Unlike conventional batteries, however, no poisonous chemicals are used to make Dr Ajayan's paper. That means it is promising for medical applications. Cellulose, which makes up more than 90% of the weight of the devices, is already used in implants. Carbon nanotubes are not fully tested in medical applications, but should be inert. And the researchers did some preliminary experiments using body fluids such as blood and sweat as electrolytes (having sweated the 1-butyl, 3-methylimidazolium chloride out first), and obtained encouraging results.

The next phase is to scale up the manufacturing process, with the aim of making the material rather as you would convert wood-pulp to newsprint. When you need more portable power, you may one day just pull some off a roll, and go.

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Microscopy

Phasing in

Aug 16th 2007
From The Economist print edition

3-D pictures of living cells show the promise of a new type of microscope

MOST cells are transparent—in other words, they are not very good at reflecting or absorbing light. To look at them under a microscope thus requires trickery. Many of these tricks kill the cells, and even those that keep them alive look only at slices through each cell, rather than seeing the whole thing in three dimensions.

Michael Feld, of the Massachusetts Institute of Technology, and his colleagues, think they can change that. They have invented a way to look at cells that are still alive. Moreover, they can do so in three dimensions. Their method is called tomographic phase microscopy, and it is reported in this week's *Nature Methods*.

Instead of relying on absorbed or reflected light, Dr Feld's technique celebrates transparency by looking at light that gets through unaltered. It does so by measuring a property called the refractive index.

This index measures the speed of light in a material. (Light zips along at the actual “speed of light”, faster than which nothing can go, only when it is travelling through a vacuum.) The different components of a cell, though transparent, have different refractive indices. Dr Feld and his team therefore set out to map what these differences are, with a view to using them to distinguish between cellular components.

To measure the refractive indices of different parts of a cell they use a technique called interferometry, which involves splitting a beam of light in two. One half, known as the object beam, passes through the cell; the other is directed along a different path and acts as a reference. The length of the reference path is such that if no sample is present, the two daughter beams will be as perfectly in phase when they meet as they were when they were separated. The crests and the troughs of their waves will reinforce each other, and the result will be brightness. The more that the light passing through the sample is slowed down, however, the more the two beams will be out of phase. Crest will fall on trough, and the result will be darkness. It is this phase shift that gives Dr Feld's new form of microscopy its name.

A single pair of beams does not, however, produce a useful image. To do that requires scanning the object beam through the target about a hundred different ways. From the refractive index of each path it is possible—with the application of some suitably crunchy computing power—to produce a three-dimensional image.

To test his idea, Dr Feld looked at cervical-cancer cells. If you identify this cancer early, the patient will probably survive. Miss it, and she will die. Dr Feld wondered if the changes that occur during cancer would show up using his new method.

They did, in a part of the cell called the nucleolus. This is the place where the components of protein factories are made. Since cancer cells grow rapidly, and thus have a high demand for proteins, it was a likely place to expect changes.

Dr Feld also has plans to use beams of different colours, since each colour has a slightly different refractive index in a given material. That would provide extra data for the computer to chew on, and probably result in better pictures. With enough pictures, Dr Feld's technique may make biology as transparent as the cells it studies.

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Herbal medicine

Growing wiser

Aug 16th 2007
From The Economist print edition

India is testing its traditional medicines

MODERN, Western medicine tends to pooh-pooh its herbal cousin. It is true that synthetic pharmaceuticals are purer, more reliable and often more effective than herbs. But many of them have herbal origins, and the sight of pharmacists botanising (collecting herbs from the countryside for sale as medicine) was common in Europe within living memory.

India, too, has a long tradition of herbal medicine, and its government is keen that this tradition should be brought into the mainstream, to the profit of the country's burgeoning drug industry. To that end, it is spending about $40m on what is known as the Golden Triangle Partnership, to assess the country's herbs scientifically, and select those suitable for serious investigation.

Most Indian herbal remedies are based on the Ayurvedic system of medicine, although Tamil-based Siddha and Unani, which has Persian roots, are also used extensively. Proving their worth is a daunting task. There are 80,000 Ayurvedic treatments alone, involving the products of some 3,000 plants. More than 7,000 firms make herbal compounds for medical use. Establishing the active ingredients and exactly how they work would thus take some time.

The Golden Triangle Partnership is not, however, looking for new molecules to turn into chemically pure drugs. Instead, it proposes to make herbal medicine itself more scientific by conducting clinical trials of traditional treatments for more than 20 medical conditions. These include arthritis, diabetes, irritable bowel syndrome, malaria and psoriasis.

To do that means getting the country's drug companies to take part in what is, for them, the non-traditional activity of traditional medicine. One of these firms, Ranbaxy, has already opened a small research and development division for herbal medicine and is beginning to look at remedies for conditions such as diabetes.

To encourage such developments the project's partners are trying to identify how the potency of herbs varies with exposure to the sun, the type of soil in which they are grown, and when and how they are harvested. With that information, they can define standard doses and clinical trials can begin. If the trials succeed, the treatments that result should be patentable—unlike the traditional formulations.

India also wants to prevent the herbs from disappearing. Some are cultivated, but most are botanised, and several of those harvested from the wild are endangered. *Swertia chirayita*, which grows in the Himalayas and treats several diseases, including malaria, is in particular danger. So some of the scientists in the project are testing similar plants that grow more abundantly in other parts of India. Tradition is a useful guide but, in herbal medicine as in other areas, innovation counts too.

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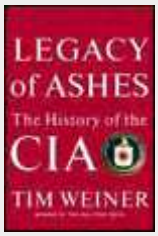
The CIA

On top of everything else, not very good at its job

Aug 16th 2007
From The Economist print edition

The United States has not, even in the eyes of well-disposed critics, been well served by its main intelligence agency

Legacy of Ashes: The History of the CIA
By Tim Weiner



Doubleday; 704 pages; $27.95.
Allen Lane; £25

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Get article background

MANY books have sought to show how badly the Central Intelligence Agency behaves. In this thorough and persuasive study, Tim Weiner describes how poorly it does its job. As a *New York Times* journalist who has covered espionage for many years, Mr Weiner knows what he is talking about. He does not play down the seamier side—for example, the opening of letters, snooping on critics, trying out drugs on Russian prisoners, plotting to kill foreign leaders and so on. Yet illegality and immorality are secondary concerns. His principal charge is incompetence, and this he pursues with the zeal of a prosecutor. The most powerful country in the world, he complains, has yet to develop “a first-rate spy service”.

He starts in 1945, when President Harry Truman decided to set up the CIA's immediate forebear, the Central Intelligence Group. He closes with the agency's unhappy part in the “war on terror” and the invasion of Iraq, one result of which was the demotion of the CIA and its director in an attempt to co-

ordinate America's often discordant intelligence outfits.

The 1947 act that set up the agency gave it two tasks: briefing the president with intelligence and conducting secret operations for him abroad. In Mr Weiner's view the CIA was lamentable at both—and most presidents must take a share of the blame.

The CIA failed to warn the White House of the first Soviet atom bomb (1949), the Chinese invasion of South Korea (1950), anti-Soviet risings in East Germany (1953) and Hungary (1956), the dispatch of Soviet missiles to Cuba (1962), the Arab-Israeli war of 1967 and Saddam Hussein's invasion of Kuwait in 1990. It overplayed Soviet military capacities in the 1950s, then underplayed them before overplaying them again in the 1970s.

The record of covert action is little better. In Japan, France and Italy the CIA sought to protect democracy by buying elections. It sponsored coups in Guatemala, Iran, Syria and Iraq, where a Baath Party leader boasted in 1963, “We came to power on an American train.” When an invasion of Cuba masterminded by the agency failed, it plotted to kill Fidel Castro. In ascending order of bloodshed, it took a hand in military coups in South Vietnam, Chile and Indonesia.

Was such skulduggery worth it? Did the extra security for the United States outweigh the immediate human cost, the frequently perverse geopolitical consequences and the moral damage to American ideals? Doubters repeatedly warned presidents that on balance the CIA's foreign buccaneering did more harm than good. Mr Weiner has dug out devastating official assessments of covert operations from the 60 years he covers suggesting that many were not worth it. The sceptics were not peaceniks or bleeding hearts but hard-headed advisers at high levels of government.

The CIA's defenders complain that only the bad news ever emerges. Yet if Mr Weiner is holding back good news, it is not for lack of searching. As 180 pages of end-notes attest, he has devoured congressional reports, former spies' memoirs and declassified papers from possibly the most unsecret service ever—a credit of a kind to American democracy.

Mr Weiner highlights many successes and is less harsh than many presidents. His title borrows a melancholy remark made by Dwight Eisenhower, who called what the CIA had wrought on his say-so “a legacy of ashes”. Richard Nixon, who had a sharp tongue, derided the agency's analysts as clowns reading newspapers.

Its very conspicuousness makes the CIA hard to put into perspective. Some people believe that its impact, for good or ill, is overdrawn. It is one American intelligence agency among many. Its budget is less than a quarter of that for eavesdropping and satellite spying, which the Pentagon controls. The armed forces also have intelligence organisations of their own.

At times recently the CIA has come to look almost dispensable. Mr Weiner's final chapter, “The Burial Ceremony”, describes the disdain in which the present administration came to hold it. By creating a new supreme post, the director of national intelligence, President George Bush has in effect robbed the CIA of direct access to the Oval Office. A 60-year struggle for influence ended with that change in 2004. In Mr Weiner's words, “The Pentagon had crushed the CIA.”

Though Mr Weiner strongly believes his country needs effective espionage, his hopes for it sound bleak. He ends with the bitter post-cold-war words of Richard Helms, one of the few CIA directors to whom he gives high marks: “The only remaining superpower doesn't have enough interest in what's going on in the world to organise and run an espionage service.”

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By Tim Weiner.
Doubleday; 704 pages; $27.95.
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Condoleezza Rice

The dazzler that dimmed

Aug 16th 2007
From The Economist print edition

Getty Images

Meteors burn bright—and fall to earth

IT IS hard to believe now, but as recently as the spring of 2005 Condoleezza Rice was being touted for the presidency of the United States. She had just been appointed secretary of state in succession to Colin Powell at the start of George Bush's second term, and a world tour was going well. In Paris, the French ambassador to America remarked, “everyone was determined to fall in love” with her. She wowed the crowds in Wiesbaden by arriving in knee-high leather boots. Her spokesman went so far as to fuel speculation about a White House bid by planting a question with a helpful journalist.

Ms Rice's star, which rose so fast, has plunged back into obscurity, and the reason is easy for anyone reading this pair of biographies to see. As secretary of state, she has mostly failed in grappling with a web of problems that she herself helped to create when she was turning out to be a notably weak national security adviser. Mr Powell presciently said of Iraq, “If you break it, you own it.” That might serve as an epitaph for Ms Rice's career at the top of American policymaking.

Of the two books, Marcus Mabry's is the more comprehensive, a full-scale biography covering Ms Rice's life from childhood in segregated and violent Birmingham, Alabama, to the present day. He takes as his book's title a saying in the Rice family that, as a black American (let alone a female one), you needed to be “twice as good” to succeed. Yet much of what he recounts belies this. Ms Rice grew up in what may then have been America's most racially charged city; she herself heard and felt the explosion when white supremacists blew up the Sixteenth Street Baptist Church there in 1963. Her family, however, moved to far more tolerant Colorado when she was 12, where her father quickly rose to a senior administrative position at the University of Denver.

Ms Rice's early career—first to a place at that same university, then to Stanford, then to the National Security Council in Washington, DC, then back to Stanford to become provost at the age of only 38—shows doors opening readily enough. Mr Mabry produces nothing to suggest she needed to be anything like twice as good.

Her biggest break came in 2000, when Candidate George Bush chose her to coach him in foreign policy, of which he admitted to knowing almost nothing. Mr Mabry makes much of the instant rapport between these two very different types, the cautious blue-stocking and the reformed hell-raiser, though he cannot

Twice as Good: Condoleezza Rice and Her Path to Power
By Marcus Mabry

Rodale; 362 pages; $27.50

Buy it at
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The Confidante: Condoleezza Rice and the Creation of the Bush Legacy
By Glenn Kessler

St Martin's Press; 304 pages; $25.95 and £17.99

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entirely explain it. Ms Rice has described the candidate as having “an incredibly inquisitive mind”. Mr Bush was later to describe Ms Rice as “the most powerful woman in the history of the world”.

Which makes it mysterious how she came to serve him so badly. The national security adviser is meant to co-ordinate foreign-policy making. Yet in that job Ms Rice seemed entirely unable to resolve the many disputes between Donald Rumsfeld at Defence and Mr Powell at State. Even without that failure, it would have been impossible not to allot her much of the blame for the mistakes in Iraq. If she realised America was sending too few troops and had rejected all post-war planning, she should have told the president: she had his ear, and access. If she did not realise, she should have done.

Mr Mabry dwells at length on Ms Rice's inability to admit to error. This quality of impenitence also extends to her refusal to accept any blame for failing to anticipate the attacks of September 11th 2001. The book presents abundant evidence of the warnings repeatedly sent to her by the CIA (one of the agency's untrumpeted successes) and of her failure to take them seriously. He notes that Ms Rice seems to have had a blind spot about the potency of terrorism in general.

Glenn Kessler's book concentrates on Ms Rice's first two years as secretary of state and her ultimately failed attempt to relaunch American foreign policy. It is a fascinating account of how diplomacy is conducted up close.

Mr Kessler pays due credit to Ms Rice's intelligence and energy. But his clear conclusion is that most of the problems she has tried to solve have been beyond her. He is excoriating about the limits of what Ms Rice's team calls “practical idealism”; to Mr Kessler the term is “nonsensical”. Her campaign for democracy in the Middle East comes in for particular criticism: when elections bring awkward results, as in Lebanon and Palestine, Ms Rice's instinct has been simply to treat the results as aberrations, ignoring her own words about democracy. The administration has long ago given up trying to promote freer societies in Saudi Arabia and Egypt, both American allies. Efforts to keep Iran non-nuclear have yielded nothing, and the war in Iraq still defies solution.

It is possible, Mr Kessler concludes, that a future historian will see Ms Rice more favourably. But, as her current job draws to an end, the prospects do not look good.

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Economic history

The merits of genteel poverty

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From The Economist print edition

WHY did the Industrial Revolution begin in the 18th century? Why did it start in Britain, a medium-sized island in north-west Europe? And, once the revolution had occurred, why did the gains accrue so disproportionately to countries in Europe and North America?

These are questions that have kept economists busy for decades. Gregory Clark, of the University of California, Davis, thinks the answers lie in the nature of European societies. “Millennia of living in stable societies, under tight Malthusian pressures that rewarded effort, accumulation and fertility limitation, encouraged the development of cultural forms—in terms of work inputs, time preference and family formation—which facilitated modern economic growth,” he contends.

This is not a fashionable thesis. Indeed, it may well get Mr Clark into trouble, given the implication that other societies are less “evolved”. His argument is that throughout the Middle Ages British society was slowly acquiring characteristics that made it a favourable agent for rapid economic change. The rich tended to have more children who survived than their poorer compatriots and this led to a kind of downward mobility as sons of merchants became small traders, sons of traders became craftsmen and so on. The result was that middle-class attributes such as patience, hard work and education spread through society. In most other countries the rich were less fecund: the Japanese samurai produced little more than one son per father, for example.

A Farewell to Alms: A Brief Economic History of the World
By Gregory Clark

Princeton University Press; 440 pages; $29.95 and £17.95

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In addition, British society also produced the preconditions for a growing economy. Interest rates fell, the hours worked rose and day-to-day acts of violence decreased. Had medieval Britain been assessed by the IMF, it would have achieved top marks: taxes were low, monetary policy was stable, property rights were secure.

None of this made much difference while Britain, like all other societies, found itself caught in the Malthusian trap. This was the grim fact identified by Thomas Malthus, an English demographer, that a country's economic potential was limited by its food supply. The trap meant that higher populations merely brought lower living standards (until 1760, the best time to have been a British labourer was after the Black Death). The trap also meant that global divergences in income were limited. In the Middle Ages, Polish workers were considered idle relative to their British counterparts, but their living standards were roughly the same; Poland was merely more sparsely populated.

Once the trap had been dealt with, by improvements in agricultural productivity and the opening up of American arable land, British society was well placed to exploit the opportunities for economic growth. These came in the 18th century in the form of new technologies in cotton production. The need to earn the income to feed its growing population gave Britain every incentive to become “the workshop of the world”.

Industrialisation also brought about a huge reduction in inequality. Real wages rose rapidly after 1820; life expectancy, just 23 years for Londoners in 1800, also improved. Competition meant that industrialists did not earn monopoly returns from the new technology, nor did the gains all accrue to landowners.

Why were these developments not matched in Asia? Mr Clark argues that Indian and Chinese societies were short of neither technology nor capital: interest rates in the 19th century were lower in India than in America. Asians were simply inefficient in their use of labour. Even though they used the same machinery as the high-wage economies, they employed many more workers per machine, without winning any extra output. Poor working habits seem to have been the cause. Even in 1955, 11% of

Indian cotton workers failed to turn up for work the day after payday.

Much of this will be rejected in the developing world, especially as it is widely believed that the British went out of their way to hobble the Indian textile industry. Mr Clark, however, has produced a well written and thought-provoking thesis, refreshingly light on jargon and equations. It could well be the subject of debate for years to come.

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A political thriller

From the compost of conflict

Aug 16th 2007
From The Economist print edition

EVERY foreign correspondent supposedly dreams of becoming a successful thriller-writer. A front-row seat at wars and revolutions provides the plots, while spooks, hacks and the other dubious habitués of conflict zones inspire the characters. And, as Frederick Forsyth, John Fullerton and Alan Furst show, a surname beginning with F also seems to be an advantage.

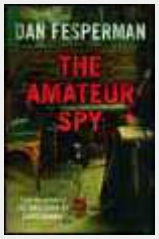
Dan Fesperman, a war correspondent with the *Baltimore Sun*, has served his time in Bosnia, Afghanistan and the Middle East. It shows: “The Amateur Spy” offers a gritty verisimilitude against a subtle political backdrop. Freeman Lockhart is a middle-aged aid-worker, fleeing African wars for the pleasures of a Greek island, with a beautiful young Bosnian wife. Their idyll ends before it begins when three thugs come calling, apparently recruited by the slimiest human-resources department of America's intelligence agencies.

Threats and blackmail send Lockhart on a mission to Amman and Jerusalem, to infiltrate a possible front for terrorist money-laundering. The book moves back and forth between the Levant and Washington, DC, where, with prophetic timing, given the recent arrests of doctors in Britain, an Arab medic is planning a terrorist outrage. The scene-setting is vivid and dramatic. A fraught, drunken dinner party among Amman's Westernised elite peels away the layers of courtesy to reveal a traumatised society.

Mr Fesperman is especially good on the murky frontier where journalists, aid-workers and spies trade information, each seeking something for nothing. He is honing the genre of intelligent political thrillers. Foreign correspondents should note: they now have some new standards to match.

The Amateur Spy.
By Dan Fesperman.
Hodder & Stoughton; 428 pages; £16.99. To be published in America by Knopf in March 2008

The Amateur Spy
By Dan Fesperman



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Sudan

Rebellions ancient and modern

Aug 16th 2007
From The Economist print edition

Get article background

KHARTOUM, Sudan's capital, has the orderly lay-out of the administrative outpost of the British empire it once was. Over the Nile, in the sprawling city of Omdurman, lies a very different town of alleyways, markets and mosques. This town was founded by the Mahdi, the late 19th-century revivalist who led an Islamist revolt against the imperialists—British, Egyptian and Turkish—in Khartoum.

The tale of the Mahdi's rebellion is familiar: the killing of Britain's General Fix-it, Charles Gordon, in 1885, and the brief triumph of the fiery Islamist before the vengeful massacre of his forces at the battle of Omdurman in 1898. What Dominic Green does in “Armies of God” is to update it for modern readers. He argues that the Mahdi's uprising was, roughly speaking, the first modern, organised Islamic military and political reaction to the hegemony of European ideas, power and territorial acquisitiveness.

The Mahdi was a man called Mohammed Ahmed, who, after immersion in the teachings of the Prophet, declared himself in 1881 to be Allah's messenger, come to redeem Sudan and the world for Islam. He denounced not only the infidel imperialists out to conquer Muslim land, but also their corrupt, apostate Islamic allies in Cairo and Istanbul. Tens of thousands of fighters rallied to his cause.

The British were drawn into a confrontation against their better judgment by the impetuous Gordon. A wilful officer who, on this account, was almost seeking martyrdom at the hands of the Mahdi, he dominates much of the book. Indeed, he becomes almost a mirror-image of the Mahdi himself.

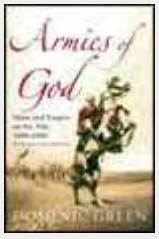
Mr Green writes engagingly, and his pen-portraits are particularly well drawn. The Tory prime minister, Lord Salisbury, for example, is presented “with his sad walrus eyes, a beard like the hedge marking an Englishman's private garden and a pained expression in which the sorrows of his early life were overlaid by the sorrows of the waning of the aristocratic age.”

The connection between the Mahdi's rebellion and the Muslim world's turbulent present sometimes, however, seems a little strained. Though the uprising can be made to sound like a precursor of today's “clash of civilisations”, as Samuel Huntington would have it, the Mahdi inspired little long-term devotion to his cause.

Yet Sudan's recent history does owe quite a lot to a brand of Islamic supremacist ideology, as M.W. Daly shows in “Darfur's Sorrow”. This carefully researched work provides an admirably full explanation of the context of Darfur's troubles. It makes clear how the conflict was precipitated by the regime of President Omar Bashir, who still denies that anything is much amiss in the region. Though most people date the fighting from 2003, Mr Daly shows that its antecedents extend well back into history: the “rebellion” of that year was an overdue response to the regime's policy of ethnic cleansing that had been going on for years.

Mr Daly details the Sudanese government's savage response: its deployment of *janjaweed* militiamen with the regular army to slaughter civilians. And he shows how this tactic had been used several times before, so nobody should have been surprised when it happened again.

Armies of God: Islam and Empire on the Nile, 1869-1899—The First Jihad of the Modern Era
By Dominic Green



Century; 384 pages; £20

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Darfur's Sorrow: A History of Destruction and Genocide
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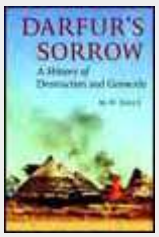

Cambridge University Press; 392 pages; $75 (hardback) and $22.99 (paperback). To be published in Britain by Cambridge University Press in October

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An exhibition in Frankfurt

The caretakers' collection

Aug 16th 2007 | FRANKFURT
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Homage to a couple who looked after more than the buildings

Hartmut and Helga, curators extraordinary

IT ALL started on Hartmut Rausch's 50th birthday in 1993. Two students of the Städelschule, Frankfurt's art school, each gave a painting to Mr Rausch and his wife Helga, the school's caretakers. The practice caught on. Over the years many Städelschule students, and some of their professors too, followed suit, filling the astonished couple's apartment with several hundred works of art.

During the past couple of months the Rauschs' rooms have been empty while the collection is being shown at the Portikus gallery down the road. Admission is free and the show runs until September 9th. On the walls are nearly 400 works, a collection that includes everything from abstracts and nudes to collages and statuettes of dogs with bulging eyes, from pop art to portraits, from landscapes to a bread duck, a papier-mâché horse and a wooden teddy bear.

For Mr Rausch, there is a story attached to each work and he recalls the tales fondly. He is no art expert, he says, but he and his wife will never sell, though some of the artists have become famous and their work is valuable. Each piece was given as a way of saying thank you to a couple who, together, have been philosopher and friend to a procession of students.

For the visitor, the show is a rare chance to see art that has been utterly insulated from commercialism from execution to acquisition to display. Unlike most exhibits in other galleries, few of the works are signed and none is labelled. And the Portikus is worth a visit in its own right: a lean, high-gabled building, it stands on an island by the Alte Brücke spanning the river Main.

When Mr and Mrs Rausch retire next year they want to take to the road with their caravan. They hope to call on artists, some famous, some not so famous, and prove Mr Rausch's belief that art is about friendship as much as objects.

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Cardinal Lustiger

Aug 16th 2007
From The Economist print edition

Aaron Jean-Marie Lustiger, cardinal and archbishop, died on August 5th, aged 80

Getty Images

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AT THE funeral of Jean-Marie Lustiger, at Notre Dame de Paris on August 10th, his second cousin Jonas Moses-Lustiger read a psalm in Hebrew and placed on the coffin a jar of earth that had been gathered on the Mount of Olives. Then another cousin, Arno Lustiger, bent over the coffin to recite Kaddish. Only when those things were done was the body of Cardinal Lustiger carried inside the cathedral, where Catholic panoply took over.

There was no question of mixing the rites; the cardinal, said his staff, would not have liked that. Yet they were mixed in himself. He was a Jew by birth, instinct, emotion and devotion; he was a Catholic by conversion and conviction. He cracked Jewish jokes, and put on a suit and *kippa* to go to synagogue, although the evening would find him in his soutane again. For him, Christianity was simply the fruit of Judaism; his first religion came to completion in his second. Christ, in his eyes, was the Messiah of Israel, his cross worthy of a yellow star. And since the mission of Israel was “to bring light to the *goyim*”, preaching the gospel became his own *mitzvah*.

The theology was complicated, despite the jut-jawed charm and aquiline intensity with which it was expressed. Many on both sides did not understand it. The Ashkenazi chief rabbi of Israel called Cardinal Lustiger a betrayer of his people; the *Jerusalem Post* denounced him as an apostate. On the Catholic side, arch-conservatives lamented that their archbishop was not “truly of French origin”.

In one sense, this was correct. His father and mother were Polish-Jewish immigrants, keeping a hat-and-drapery shop in Montparnasse, in Paris. The young Aaron had been protected from Christianity, kept inside during Christian festivals and made aware that his grandfather had been a Yiddish-speaking rabbi in Silesia. But he had found a New Testament at his piano teacher's and discovered, as he read it, that he seemed to know this story already.

The moment of conversion came at 14, in Orléans, where his family had taken sporadic shelter in a Catholic household during the war. On Holy Thursday he stole into Orléans cathedral to find it blazing with candles and flowers. The next day, Good Friday, he found the church stripped as a sign of desolation. Christ's presence, followed by Christ's absence, impressed him so deeply that he asked to be baptised. Explaining to his parents was “unbearably painful”; outraged, they called in a rabbi, but the rabbi seemed to think their boy was either deluded, or sensible. Fourteen years later he was ordained a priest.

The future cardinal was convinced, even then, that he had not abandoned one iota of his Jewishness. To say he had, he once explained, “is like denying my father and mother, my grandfathers and grandmothers”. He had kept the name Aaron as his first name at baptism, only adding Christian ones. At the same time, those who thought this a conversion of convenience, to save his hide, were wrong. He had not wanted to save his hide. Like most survivors, he constantly mourned the members of his family who had died in the camps, especially his mother, who was transported to Auschwitz in 1942. He would say Kaddish for her on her death day, and on his first visit to Auschwitz, in 1983, he slipped away to kneel in the grass among the barracks, in his archiepiscopal robes with his scarlet skull-cap, and cry.

Motorbike and bulldozer

Possibly because that wound had never healed, possibly because melancholy kept dogging him, he pursued his career as a priest with a wild, frenetic energy. As a chaplain in the Paris universities, a post he held from 1954-69, “Lulu” was remembered in sharp black corduroys and black loafers, tearing round the Latin Quarter on a motorbike. As Archbishop of Paris, in 1984, he led a demonstration of a million people to protest against François Mitterrand's attempt to secularise Catholic schools. He set up Radio Notre Dame and a Catholic TV station; in his 70s, in 1997 and 2000, he organised joyous World Youth Days in Paris and in Rome. Fervent for evangelisation, “the Bulldozer” gingered up all his 106 parishes in Paris, summarily shifted clergy who failed to perform, and founded his own seminary, which eventually provided about 15% of the city's priests.

Though a new broom and a gale of fresh air, unafraid to shout “Merde!” if a crucifix fell over, he was intellectually conservative. Most of the world's wrongs, including fascism, communism and anti-Semitism, he traced to the Enlightenment and the cult of reason. Relativism and the collapse of moral values he blamed on the student riots of 1968, “this bedlam”, in which he had refused to take the students' side. All his instincts and emotions, as well as his Polish background, endeared him to John Paul II, and it was under the mantle of that friendship that he rose first to bishop of Orléans, then to archbishop, and finally to cardinal, all within five years.

But he never forgot. He taught himself Hebrew in readiness for his *aliyah*, or formal return to Israel. Every detail of his funeral, with its two rites, he carefully arranged himself. Then he wrote his epitaph:

> I was born Jewish. I received the name of my paternal grandfather, Aaron. Having become Christian by faith and baptism, I have remained Jewish. As did the Apostles.

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Overview

Aug 16th 2007
From The Economist print edition

GDP in the **euro area** rose by 0.3% in the second quarter, a smaller-than-expected increase, leaving it 2.5% higher than a year earlier. The second-quarter increase in GDP in both France and Germany was in line with the euro-area average. Spain's GDP rose by 0.8% in the same period.

Consumer prices in **America** rose by 0.1% in July and by 2.4% from a year earlier. Prices excluding food and energy rose by 0.2% in the month, the same as in June. Both industrial output and the value of retail sales rose by 0.3% in July.

Japan's GDP rose by 0.1% in the second quarter and by 2.3% from a year earlier.

In **Britain** consumer prices rose by 1.9% in the year to July, down from a 2.4% rate in June and below the government's 2% target for the first time since March 2006. The unemployment rate was 5.4% in the three months to June, down from 5.5% in the three months to March. Average earnings rose 3.3% in the year to the second quarter, the lowest increase for nearly four years.

China's consumer prices rose by 5.6% in the year to July, the biggest increase for ten years, because of sharp rises in the cost of meat. The inflation rate excluding food prices was a less alarming 0.9%.

Norway's central bank raised its benchmark interest rate from 4.5% to 4.75% on August 15th. The bank said that financial-market turbulence did not warrant a departure from its monetary strategy set out in June.

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Output, prices and jobs

Aug 16th 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+1.8 Q2	+3.4	+2.0	+2.6	+1.4 Jul	+2.4 Jul	+4.1	+2.8	4.6 Jul
Japan	+2.3 Q2	+0.5	+2.6	+2.3	+1.1 Jun	–0.2 Jun	+0.5	nil	3.7 Jun
China	+11.9 Q2	na	+10.5	+9.6	+18.0 Jul	+5.6 Jul	+1.0	+3.0	9.5 2006
Britain	+3.0 Q2	+3.3	+2.8	+2.3	+0.8 Jun	+1.9 Jul**	+2.4	+2.4	5.4 Jun††
Canada	+2.0 Q1	+3.7	+2.5	+2.7	–0.1 May	+2.2 Jun	+2.4	+2.4	6.0 Jul
Euro area	+2.5 Q2	+1.2	+2.7	+2.3	+2.3 Jun	+1.8 Jul	+2.4	+2.0	6.9 Jun
Austria	+3.8 Q2	+4.0	+3.0	+2.7	+7.7 May	+2.1 Jul	+1.8	+1.9	4.3 Jun
Belgium	+2.9 Q2	+2.4	+2.7	+2.4	+1.8 May	+1.4 Jul	+1.6	+1.8	10.5 Jun‡‡
France	+1.3 Q2	+1.3	+2.0	+2.2	–0.8 Jun	+1.1 Jul	+1.9	+1.5	8.0 Jun
Germany	+2.5 Q2	+1.0	+2.8	+2.4	+4.9 Jun	+1.9 Jul	+1.9	+1.9	9.0 Jul
Greece	+4.2 Q2	na	+3.7	+3.2	+1.3 Jun	+2.5 Jul	+3.8	+2.6	8.4 Apr
Italy	+1.8 Q2	+0.5	+2.0	+1.7	–0.1 Jun	+1.6 Jul	+2.2	+1.9	6.2 Q1
Netherlands	+2.4 Q2	+0.6	+2.8	+2.6	+2.2 May	+1.5 Jul	+1.6	+1.9	4.7 Jul††
Spain	+4.0 Q2	+3.2	+3.7	+2.7	+2.0 Jun	+2.2 Jul	+4.0	+2.7	8.0 Jun
Czech Republic	+6.1 Q1	+6.1	+5.2	+4.0	+6.9 Jun	+2.3 Jul	+2.9	+2.5	6.4 Jul
Denmark	+2.3 Q1	+2.2	+2.1	+2.0	–2.5 Jun	+1.2 Jul	+2.0	+1.9	3.5 Jun
Hungary	+1.4 Q2	+0.8	+2.7	+3.0	+8.9 Jun	+8.4 Jul	+3.0	+7.3	7.0 Jun††
Norway	+2.8 Q1	+2.9	+2.7	+2.5	–3.9 May	+0.4 Jul	+2.2	+0.8	2.5 Jun††
Poland	+7.4 Q1	na	+6.3	+5.1	+5.6 Jun	+2.3 Jul	+1.1	+2.1	12.4 Jun‡‡
Russia	+7.9 Q1	na	+6.7	+6.2	+7.8 Jul	+8.8 Jul	+9.6	+7.8	6.7 Jun‡‡
Sweden	+3.6 Q2	+3.9	+3.5	+3.2	+5.0 Jun	+1.9 Jul	+1.7	+2.1	4.9 Jun‡‡
Switzerland	+2.4 Q1	+3.2	+2.4	+2.1	+7.3 Q1	+0.7 Jul	+1.4	+0.7	2.5 Jul‡‡
Turkey	+6.8 Q1	na	+6.0	+5.2	+1.8 Jun	+6.9 Jul	+11.7	+9.4	8.9 Q2‡‡
Australia	+3.8 Q1	+6.6	+3.6	+3.3	+5.5 Q1	+2.1 Q2	+4.0	+2.3	4.3 Jul
Hong Kong	+5.6 Q1	+2.0	+5.7	+5.0	–1.5 Q1	+1.3 Jun	+2.2	+2.0	4.2 Jun††
India	+9.1 Q1	na	+8.5	+8.0	+9.8 Jun	+5.7 Jun	+7.7	+5.9	7.6 2006
Indonesia	+6.3 Q2	na	+6.3	+6.2	+11.8 May	+6.1 Jul	+15.2	+5.8	9.8 Feb
Malaysia	+5.3 Q1	na	+5.9	+5.8	+0.5 Jun	+1.4 Jun	+3.9	+2.4	3.4 Q1
Pakistan	+6.6 2006§§	na	+6.4	+5.9	+7.1 May	+7.0 Jun	+7.6	+6.3	na
Singapore	+8.6 Q2	+14.0	+6.2	+4.4	–7.4 Jun	+1.3 Jun	+1.4	+0.9	2.4 Q2
South Korea	+4.9 Q2	+7.0	+4.5	+4.7	+7.6 Jun	+2.5 Jul	+2.4	+2.4	3.4 Jul
Taiwan	+4.2 Q1	na	+4.4	+4.6	+7.5 Jun	–0.3 Jul	+0.8	+1.2	3.9 Jun
Thailand	+4.3 Q1	+4.9	+4.2	+4.9	+6.3 May	+1.7 Jul	+4.4	+2.6	1.6 Mar
Argentina	+8.0 Q1	+4.1	+7.5	+5.5	+0.3 Jun	+8.6 Jul	+10.6	+9.3	9.8 Q1‡‡
Brazil	+4.3 Q1	+3.2	+4.3	+3.8	+6.6 Jun	+3.7 Jul	+4.0	+3.5	9.7 Jun‡‡
Chile	+5.8 Q1	na	+5.9	+5.3	+6.7 Jun	+3.8 Jul	+3.8	+3.0	6.9 Jun††††
Colombia	+8.1 Q1	+10.3	+6.4	+5.1	+11.9 May	+5.8 Jul	+4.3	+5.7	11.1 Jun‡‡
Mexico	+2.6 Q1	+0.6	+3.1	+3.5	+0.1 Jun	+4.1 Jul	+3.1	+3.9	3.3 Jun‡‡
Venezuela	+8.9 Q2	na	+5.9	+4.0	+10.0 Apr	+17.2 Jul	+13.5	+18.1	8.0 Q2‡‡
Egypt	+7.4 Q1	na	+7.0	+7.2	+10.5 2006	+8.0 Jul	+8.4	+8.4	9.0 Q4‡‡
Israel	+5.4 Q1	+6.3	+5.1	+4.5	+6.6 May	+0.3 Jul	+2.4	+0.3	7.7 Q1
Saudi Arabia	+4.3 2006§	na	+4.0	+5.7	na	+3.0 Jun	+1.8	+3.0	na
South Africa	+5.4 Q1	+4.7	+4.8	+5.2	+2.0 Jun	+7.0 Jun	+4.9	+5.8	25.5 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+7.3 Q2	na	+9.4	+5.8	+6.2 May	+5.8 Jun	+4.3	+5.5	5.2 May
Finland	+5.4 Q1	+3.4	+3.6	+2.6	+0.3 Jun	+2.6 Jul	+1.9	+1.4	6.6 Jun
Iceland	–0.1 Q1	–3.6	+0.8	+1.8	+7.6 2006	+3.4 Aug	+8.6	+4.6	1.0 Jun‡‡
Ireland	+7.5 Q1	+20.1	+4.8	+3.4	–5.6 May	+5.0 Jul	+4.2	+4.5	4.6 Jun
Latvia	+11.3 Q2	na	+9.6	+7.5	+3.4 May	+8.8 Jun	+6.3	+7.9	5.9 May
Lithuania	+8.3 Q1	+6.1	+7.5	+6.7	na	+4.8 Jun	+3.7	+4.5	2.7 Jun
Luxembourg	+6.2 Q1	+6.6	+5.2	+4.3	+1.6 Apr	+2.0 Jun	+3.2	+2.2	4.1 May‡‡
New Zealand	+2.7 Q1	+2.5	+3.9	+3.1	nil Q1	+2.0 Q2	+4.0	+2.4	3.6 Q2
Peru	+6.7 Jun	na	+7.1	+5.5	+12.3 May	+2.2 Jul	+1.5	+1.2	7.6 Jun‡‡
Philippines	+6.9 Q1	+10.3	+6.0	+5.6	–7.1 May	+2.6 Jul	+6.4	+2.9	7.4 Q2‡‡
Portugal	+1.6 Q2	+1.7	+1.8	+2.1	+0.6 Jun	+2.4 Jul	+3.0	+2.3	8.4 Q1‡‡
Slovakia	+9.2 Q2	nil	+8.0	+6.0	+12.0 Jun	+2.3 Jul	+5.0	+2.5	8.3 May
Slovenia	+7.2 Q1	na	+5.6	+4.6	+6.0 Jun	+3.8 Jul	+1.9	+3.0	7.7 May‡‡

*% change on previous quarter, annual rate. †*The Economist* poll. ‡National definitions. §Economist Intelligence Unit estimate/forecast. **RPI inflation rate 3.8% in Jul. ††Latest three months. ‡‡Not seasonally adjusted. §§Year ending June.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Aug 16th 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Aug 7th	Aug 14th*	% change on one month	% change on one year
Dollar index				
All items	204.3	202.6	–0.6	+17.2
Food	174.7	176.5	+3.2	+31.3
Industrials				
All	242.5	236.3	–4.1	+6.2
Nfa†	163.6	160.3	–1.7	+6.3
Metals	285.6	277.8	–4.8	+6.2
Sterling index				
All items	153.2	153.6	+1.6	+11.1
Euro index				
All items	137.2	138.0	+1.0	+10.4
Gold				
$ per oz	670.75	668.80	+0.4	+7.6
West Texas Intermediate				
$ per barrel	72.30	72.39	–2.3	–0.9

*Provisional †Non-food agriculturals.

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Job vacancies in Europe

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From The Economist print edition

Western Europe has enjoyed a period of strengthening labour demand, according to the Monster Employment Index. Using data from 148 job boards across Europe, the index measures the strength of online hiring intentions. Large economies like Germany, France and Poland are seeing the biggest demand increases. Labour markets in the smaller Nordic, Baltic and Central European countries are becoming less buoyant. In Europe as a whole, vacancies in the manufacturing and telecoms industries rose sharply in July. Finance and law saw big falls. In terms of individual occupations, plant and machine operators are increasingly sought-after. Jobs for legislators, senior officials and managers are plentiful too.

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Trade, exchange rates, budget balances and interest rates

Aug 16th 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†‡	Currency units, per $ Aug 15th	Currency units, per $ year ago	Budget balance % of GDP 2007‡	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	–823.4 Jun	–803.4 Q1	–5.8	–	–	–1.2	5.39	4.75
Japan	+94.9 Jun	+192.6 Jun	+4.4	117	116	–2.9	0.67	1.66
China	+238.7 Jul	+249.9 2006	+10.7	7.59	7.99	–0.7	3.20	4.32
Britain	–155.8 Jun	–93.0 Q1	–3.2	0.50	0.53	–2.7	6.35	5.12
Canada	+50.0 Jun	+18.5 Q1	+1.6	1.08	1.12	0.6	4.39	4.44
Euro area	+15.9 May	–1.0 May	+0.1	0.74	0.78	–0.7	4.53	4.33
Austria	+1.0 May	+13.2 Q1	+3.0	0.74	0.78	–0.8	4.53	4.44
Belgium	+18.1 Jun	+12.5 Mar	+2.2	0.74	0.78	nil	4.59	4.45
France	–38.0 Jun	+15.7 Jun	–1.0	0.74	0.78	–2.5	4.53	4.41
Germany	+239.9 Jun	+182.2 Jun	+4.9	0.74	0.78	0.5	4.53	4.33
Greece	–47.4 May	–33.6 May	–8.4	0.74	0.78	–2.4	4.52	4.63
Italy	–21.2 May	–49.8 May	–2.3	0.74	0.78	–2.6	4.53	4.61
Netherlands	+47.1 Jun	+53.5 Q2	+7.7	0.74	0.78	0.6	4.53	4.41
Spain	–119.6 May	–119.7 May	–8.8	0.74	0.78	2.0	4.53	4.43
Czech Republic	+2.9 Jun	–5.0 Jun	–4.1	20.7	21.9	–4.2	3.29	4.40
Denmark	+5.4 Jun	+5.3 Jun	+2.1	5.52	5.81	3.8	4.70	4.40
Hungary	–2.2 Jun	–6.2 Q1	–5.2	191	214	–6.5	7.68	6.60
Norway	+54.0 Jul	+57.3 Q1	+14.9	5.90	6.27	16.8	5.16	4.94
Poland	–7.5 May	–11.5 Jun	–2.7	2.83	3.01	–2.4	4.90	5.56
Russia	+126.9 Jun	+77.7 Q2	+6.8	25.7	26.7	3.0	10.00	6.11
Sweden	+19.5 Jun	+29.8 Q1	+6.8	6.95	7.16	2.4	3.24	4.26
Switzerland	+11.0 Jun	+102.1 Q1	+16.1	1.22	1.23	0.3	2.75	3.00
Turkey	–54.1 Jun	–31.7 Jun	–6.3	1.33	1.44	–2.8	18.64	6.65§
Australia	–10.9 Jun	–43.8 Q1	–5.4	1.21	1.30	1.3	6.95	5.89
Hong Kong	–19.6 Jun	+23.2 Q1	+10.1	7.82	7.78	1.8	4.74	4.37
India	–67.7 Jun	–9.6 Q1	–1.1	40.8	46.6	–3.3	6.55	8.29
Indonesia	+42.1 Jun	+10.3 Q1	+1.9	9,426	9,093	–1.6	8.20	6.96§
Malaysia	+28.9 Jun	+25.9 Q1	+11.0	3.49	3.68	–3.2	3.62	5.29§
Pakistan	–13.4 Jun	–6.8 Q1	–4.6	60.4	60.3	–4.7	9.81	9.01§
Singapore	+35.5 Jun	+41.6 Q2	+24.0	1.53	1.57	0.3	2.69	2.85
South Korea	+19.4 Jul	+5.2 Jun	+1.0	932	965	0.5	5.22	5.31
Taiwan	+12.3 Jul	+28.1 Q1	+6.1	33.0	32.7	–2.0	2.55	2.52
Thailand	+9.3 Jun	+11.1 Jun	+2.3	34.2	37.4	–1.9	3.55	4.26
Argentina	+11.2 Jun	+7.8 Q1	+3.2	3.15	3.08	1.3	11.44	na
Brazil	+45.0 Jul	+15.0 Jun	+0.8	1.99	2.13	–2.4	11.43	6.16§
Chile	+25.5 Jun	+7.1 Q1	+5.2	523	536	6.6	5.52	5.44§
Colombia	–0.9 Apr	–4.1 Q1	–3.0	2,043	2,356	–0.8	8.78	6.47§
Mexico	–11.8 Jun	–5.5 Q1	–0.9	11.1	10.8	0.1	7.21	7.92
Venezuela	+28.2 Q1	+20.4 Q2	+9.8	2,147	2,650	–3.7	11.09	6.55§
Egypt	–14.1 Q1	+3.1 Q1	+1.2	5.66	5.74	–5.6	7.20	5.44§
Israel	–8.5 Jul	+8.1 Q1	+3.5	4.22	4.36	–1.1	4.24	5.61
Saudi Arabia	+146.6 2006	+98.9 2006	+25.8	3.75	3.75	19.4	5.02	na
South Africa	–9.3 Jun	–16.6 Q1	–6.8	7.34	6.78	0.5	10.05	8.51
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	–4.1 May	–3.1 Apr	–16.5	11.6	12.2	1.7	4.82	na
Finland	+12.3 Jun	+12.1 Jun	+6.6	0.74	0.78	4.1	4.49	4.41
Iceland	–1.8 Jul	–4.0 Q1	–16.8	67.1	69.1	3.7	14.07	na
Ireland	+34.9 May	–10.6 Q1	–4.9	0.74	0.78	0.9	4.53	4.42
Latvia	–6.7 Jun	–5.7 Jun	–22.2	0.52	0.54	nil	7.30	na
Lithuania	–6.4 Jun	–4.2 Jun	–12.5	2.56	2.69	–0.5	5.22	na
Luxembourg	–5.5 May	+4.5 Q1	na	0.74	0.78	0.3	4.53	na
New Zealand	–4.2 Jun	–9.1 Q1	–10.7	1.39	1.56	4.8	7.20	6.32
Peru	+9.0 Jun	+2.7 Q1	+1.9	3.14	3.22	0.4	4.73	na
Philippines	–3.3 May	+5.7 Mar	+5.1	46.2	51.3	–1.1	6.81	na
Portugal	–23.3 May	–17.8 May	–7.9	0.74	0.78	–3.3	4.53	4.57
Slovakia	–2.1 Jun	–3.5 Apr	–4.3	25.0	29.2	–2.9	4.15	4.63
Slovenia	–2.4 Jun	–1.6 May	–2.6	0.74	0.78	–1.2	na	na

*Merchandise trade only. †*The Economist* poll. ‡Economist Intelligence Unit forecast. §Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Aug 16th 2007
From The Economist print edition

Markets

	Index Aug 15th	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	12,861.5	–5.8	+3.2	+3.2
United States (S&P 500)	1,406.7	–6.1	–0.8	–0.8
United States (NAScomp)	2,458.8	–5.9	+1.8	+1.8
Japan (Nikkei 225)	16,475.6	–3.3	–4.4	–2.8
Japan (Topix)	1,594.2	–4.5	–5.2	–3.6
China (SSEA)	5,111.6	+4.5	+81.6	+86.8
China (SSEB, $ terms)	320.7	+1.5	+139.5	+146.5
Britain (FTSE 100)	6,109.3	–4.5	–1.8	–0.1
Canada (S&P TSX)	13,048.8	–5.2	+1.1	+9.3
Euro area (FTSE Euro 100)	1,312.1	–4.0	+2.6	+4.8
Euro area (DJ STOXX 50)	4,183.1	–4.2	+1.5	+3.7
Austria (ATX)	4,529.5	–2.8	+1.5	+3.7
Belgium (Bel 20)	4,114.9	–4.8	–6.2	–4.2
France (CAC 40)	5,442.7	–5.3	–1.8	+0.3
Germany (DAX)*	7,445.9	–2.1	+12.9	+15.3
Greece (Athex Comp)	4,689.1	–3.1	+6.7	+9.0
Italy (S&P/MIB)	39,247.0	–3.4	–5.3	–3.2
Netherlands (AEX)	506.0	–4.7	+2.2	+4.4
Spain (Madrid SE)	1,597.8	–3.2	+2.8	+5.0
Czech Republic (PX)	1,749.7	–3.2	+10.1	+11.1
Denmark (OMXCB)	455.8	–5.7	+7.5	+10.0
Hungary (BUX)	27,017.4	–5.3	+8.7	+8.8
Norway (OSEAX)	531.4	–5.4	+5.8	+11.6
Poland (WIG)	59,123.7	–3.6	+17.3	+20.2
Russia (RTS, $ terms)	1,886.8	–5.1	–4.3	–1.8
Sweden (Aff.Gen)	376.3	–4.3	+3.0	+1.5
Switzerland (SMI)	8,661.6	–3.4	–1.4	–1.2
Turkey (ISE)	47,714.1	–8.4	+22.0	+29.6
Australia (All Ord.)	5,801.5	–5.3	+2.8	+6.6
Hong Kong (Hang Seng)	21,375.7	–5.2	+7.1	+6.5
India (BSE)	15,000.9	–2.0	+8.8	+18.2
Indonesia (JSX)	2,029.1	–10.3	+12.4	+7.2
Malaysia (KLSE)	1,251.8	–4.2	+14.2	+15.5
Pakistan (KSE)	12,786.6	–5.7	+27.4	+28.3
Singapore (STI)	3,273.3	–4.1	+9.6	+9.9
South Korea (KOSPI)	1,817.9	–4.5	+26.7	+26.4
Taiwan (TWI)	8,593.0	–5.6	+9.8	+8.4
Thailand (SET)	773.9	–6.9	+13.8	+20.5
Argentina (MERV)	1,924.7	–10.8	–7.9	–10.4
Brazil (BVSP)	49,285.0	–10.8	+10.8	+19.0
Chile (IGPA)	13,936.1	–4.9	+12.6	+14.7
Colombia (IGBC)	10,474.8	–5.0	–6.1	+2.9
Mexico (IPC)	28,140.7	–8.2	+6.4	+3.7
Venezuela (IBC)	40,927.3	+0.7	–21.6	+22.0
Egypt (Hermes)	71,707.3	–0.6	+17.0	+18.1
Israel (TA-100)	1,044.4	–2.8	+13.3	+13.1
Saudi Arabia (Tadawul)	7,900.9	+2.4	–0.4	–0.4
South Africa (JSE AS)	27,091.1	–4.0	+8.7	+4.4
Europe (FTSEurofirst 300)	1,491.8	–4.0	+0.6	+2.7
World, dev'd (MSCI)	1,494.5	–6.0	+0.7	+0.7
Emerging markets (MSCI)	1,014.0	–7.3	+11.1	+11.1
World, all (MSCI)	373.8	–6.1	+1.6	+1.6
World bonds (Citigroup)	675.7	nil	+2.6	+2.6
EMBI+ (JPMorgan)	406.8	–1.3	–0.1	–0.1
Hedge funds (HFRX)	1,298.0	–2.2	+1.7	+1.7
Volatility, US (VIX)	30.7	21.5	11.6	(levels)
CDSs, Eur (iTRAXX)†	53.8	+25.2	+130.6	+135.6
CDSs, N Am (CDX)†	79.9	+32.6	+138.9	+138.9
Carbon trading (EU ETS) €	0.07	–12.5	–98.9	–98.9

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EFX; HKMA; Markit; Standard Bank

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The Economist commodity-price index

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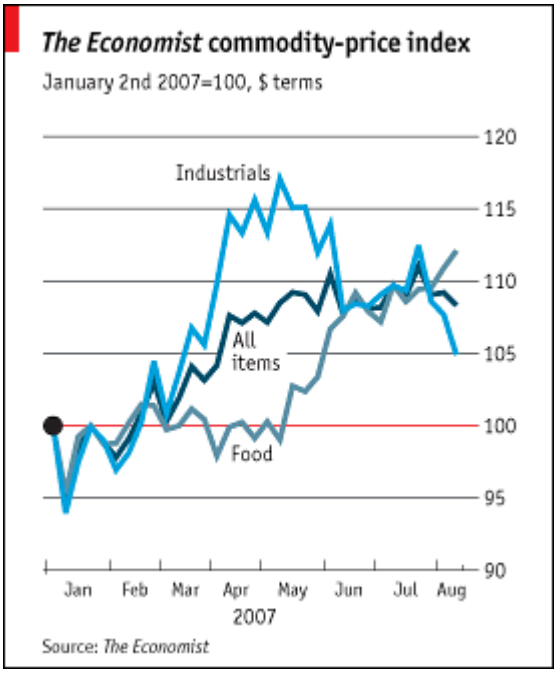

The Economist's dollar industrials index fell by 3% this week as investment funds sold commodities on fears of a slow-down in economic growth in the wake of a world credit squeeze. Our metals index is now 14% below its peak in May. Nickel prices have fallen by half in three months; tin has fallen 12% from the record price touched earlier this month. By contrast, our food index has gained 13% since May. Wheat prices are up by more than a third this year and, with world stocks at a 30-year low, are forecast to reach new highs in 2007-08. Coffee prices are also expected to be strong. Brazil's crop is forecast to fall by 25% in 2007-08. However sugar prices may fall thanks to a surplus–India's output rose by 39% this season.

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